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No. __-___

IN THE

Supreme Court of the United States

ENRON POWER MARKETING, INC.,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI (Volume I)

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APPENDIX A

Judgment of the United States Court of Appeals for the District of Colombia Circuit filed June 30, 2000

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group, et al.
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1112, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

BEFORE: Sentelle, Randolph, and Tatel, *Circuit Judges*.

JUDGMENT

These causes came on to be heard on the petitions for review of orders of the Federal Energy Regulatory Commission and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by the Court, that the petitions for review are granted in part and denied in part, in accordance with the opinion for the Court filed herein this date.

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Date: June 30, 2000

Opinion Per Curiam

UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT
Filed: JUN 30 2000
Clerk

MANDATE
Pursuant to the provisions of Fed. R. App. Pro. 41(a)

ISSUED: 8/30/00

By: E. Brown

ATTACHED: –Amending Order
–Opinion
–Order on Costs

APPENDIX B

Opinion of the United States Court of Appeals for the District of Columbia Circuit filed June 30, 2000

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued November 3, 1999 Decided June 30, 2000

No. 97-1715

Transmission Access Policy Study Group, et al.
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department Of Public Service, et al.,
Intervenors

[Page 2]Consolidated with
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Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Sherilyn Peterson, John T. Miller, Jr., Robert C. McDiarmid, Stanley C. Fickle, Sara D. Schotland, Jeffrey L. Landsman, Lawrence G. Malone, Jeffery D. Watkiss, Richard M. Lorenzo, Isaac A. Benkin, Wallace E. Brand, Daniel I. Davidson, Cynthia S. Bogorad, Harvey L. Reiter and *Randolph Lee Elliott* argued the causes for petitioners. With them on the briefs were *William R. Maurer, Ben Finkelstein, David E. Pomper, Ronald N. Carroll, John Michael Adragna, Sean T. Beeny, Wallace F. Tillman, Susan N. Kelly, Craig W. Silverstein, A. Hewitt Rose, Bryan G. Tabler, James D. Pembroke, David C. Vladeck, Robert F. Shapiro, Lynn N. Hargis, Wallace L. Duncan, Richmond F. Allan, Alan H. Richardson, Michael A. Mullett, C. Kirby Mullen, Robert A. Jablon, Sara C. Weinberg, John F. Wickes, Jr., Todd A. Richardson, Brian A. Statz, John P. Cook, Charles F. Wheatley, Jr., Christine C. Ryan, Robert S. Tongren, Joseph P. Serio, Barry E. Cohen, Carrol S. Verosky, Jennifer S. McGinnity, Jonathan D. Feinberg, Charles D. Gray, Robert Vandiver, Cynthia Miller, Helene S. Wallenstein, William H. Chambliss, C. Meade Browder, Jr., Mary W. Cochran, Paul R. Hightower, Brad M. Purdy, Gisele L. Rankin, Robert D. Cedarbaum, Edward H. Comer, Edward Berlin,* [Page 3] *Robert V. Zener, Elizabeth W. Whittle, James H. McGrew, Donald K. Dankner, Frederick J. Killion, Joseph L. Lakshmanan, Stephen C. Palmer, Michael E. Ward, Steven J. Ross, Marvin T. Griff* and *Thomas C. Trauger. Leja D. Courter, Robert E. Glennon, Jr., Neil Butterklee, Zachary D. Wilson, Sheila S. Hollis, Janice L. Lower* and *James B. Ramsay* entered appearances.

John H. Conway, Deputy Solicitor, Federal Energy Regulatory Commission, and *Timm L. Abendroth* and *Larry D. Gasteiger*, Attorneys, argued the causes for respondent. With them on the brief was *Jay L. Witkin*, Solicitor. *Susan J.*

Court, Special Counsel, and *Edward S. Geldermann*, Attorney, entered appearances.

Edward Berlin argued the cause for intervenors. With him on the briefs were *J. Phillip Jordan, Robert V. Zener, Edward H. Comer, William M. Lange, Deborah A. Moss, James H. McGrew, Steven J. Ross, Elizabeth W. Whittle, Richard M. Lorenzo, David M. Stahl, D. Cameron Findlay, Peter Thornton, J. Phillip Jordan, Robert V. Zener, Robert C. McDiarmid, Cynthia S. Bogorad, Ben Finkelstein, Peter J. Hopkins, Margaret A. McGoldrick, Jeffery D. Watkiss, Ronald N. Carroll, Sara D. Schotland, Alan H. Richardson, Wallace L. Duncan, Richmond F. Allan, A. Hewitt Rose, Wallace F. Tillman, Susan N. Kelly, John M. Adragna, Sean T Beeny* and *Randolph Lee Elliott. Edward J. Twomey, Richard P. Bonnifield, Frederick H. Ritts, David L. Huard, Dan H. McCrary, Mark A. Crosswhite, John N. Estes, III, Kevin J. McIntyre, John S. Moot, Clark E. Downs, Martin V. Kirkwood, Robert A. Waters, John T. Stough, Jr., Bruce L. Richardson, Floyd L. Norton, IV, William S. Scherman, Douglas F. John, Gary D. Bachman, Nicholas W. Fels, Robert Weinberg, Robert A. Jablon, Peter G. Esposito, Christine C. Ryan, Sheila S. Hollis, Stephen L. Teichler, James K. Mitchell, Gordon J. Smith, Edward J. Brady, Kevin F. Duffy, Michael P. May, Barbara S. Brenner, Michael J. Rustum, Sandra E. Rizzo, Kirk H. Betts, Pierre F. de Ravel d'Esclapon, Glen L. Ortman* and *William D. DeGrandis* entered appearances.

[Page 4] Before: SENTELLE, RANDOLPH and TATEL, Circuit Judges.

Opinion for the Court filed PER CURIAM[1]:

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[1] Following our normal practice in complex cases, we shared the writing of this opinion. Judge Sentelle wrote Section II, Section III, and Section VII. Judge Randolph wrote Section IV, Section VI, and Section VIII. Judge Tatel wrote Section I Section V, and Section IX.

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Following two notices of proposed rulemaking, the Federal Energy Regulatory Commission issued Orders 888 and 889 on April 24, 1996[2]. Reflecting the Commission's effort to end [Page 7] discriminatory and anticompetitive practices in the national electricity market and to ensure that electricity customers pay the lowest prices possible, these orders represent, as the Commission described in a later order not before us, "the foundation necessary to develop competitive bulk power markets...." Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 810, 812 (2000).

Open access is the essence of Orders 888 and 889. Under these orders, utilities must now provide access to their

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[2] Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996) ("Order 888"), on reh'g, Order No. 888-A, FERC Stats. and Regs. ¶ 31,048, 62 Fed. Reg. 12,274, clarified, 79 FERC ¶ 61,182 (1997), on reh'g, Order No. 888-B, 81 FERC ¶ 61,248, 62 Fed. Reg. 64,688 (1997), on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998); Open Access Same-Time Information System and Standards of Conduct, Order No. 889, FERC Stats. & Regs. ¶ 31,035, 61 Fed. Reg. 21,737 (1996) ("Order 889"), on reh'g, Order No. 889-A, FERC Stats. & Regs. ¶ 31,049, 62 Fed. Reg. 12,484 (1997), on reh'g, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

transmission lines to anyone purchasing or selling electricity in the interstate market on the same terms and conditions as they use their own lines. By requiring utilities to transmit competitors' electricity, open access transmission is expected to increase competition from alternative power suppliers, giving consumers the benefit of a competitive market. Most fundamentally, FERC's open access policies, combined with parallel action now occurring on the state level, are intended to create a market in which customers may purchase power from any of a number of suppliers. A municipality or factory in Florida, for example, will no longer have to purchase power from its local utility but instead may seek cheaper power anywhere in the country. A customer in Vermont may purchase electricity from an environmentally friendly power producer in California or a cogeneration facility in Oklahoma.

All key players in the electricity market have challenged various provisions of Orders 888 and 889. Their claims range from the hypertechnical to arguments that FERC lacks authority to order open access transmission at all. Finding few defects in the orders we uphold them in nearly all respects.

I. INTRODUCTION

Historically, vertically integrated utilities owned generation, transmission, and distribution facilities. They sold gen-[Page 8]eration, transmission, and distribution services as part of a "bundled" package. Due to technological limitations on the distance over which electricity could be transmitted, each utility served only customers in a limited geographic area. And because of their natural monopoly characteristics, utilities have been heavily regulated at both the federal and state levels.

Since enactment of the Federal Power Act in 1935, the electricity industry has undergone significant change, both economically and technologically. Economies of scale have

justified the construction of large (greater than 500 MW) generation facilities, such as nuclear power plants. Technological advances in the 1970s and 1980s have permitted small plants to operate efficiently as well. See Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,514 at 33,059-60, 60 Fed. Reg. 17,662 (1995) ("Open Access NOPR"). Technological improvements also made feasible the transmission of electric power over long distances at high voltages. See id. ¶ 32,514 at 33,060. Alternative power suppliers, such as cogenerators, small power producers, and independent power producers emerged in response to these developments. Constructing and operating generation capacity at prices lower than the embedded generation costs of traditional utilities, these alternative suppliers have created a wholesale market for low-cost power.

The growth of this new wholesale market faced a serious obstacle. "As entry into wholesale power generation markets increased," FERC explained, "the ability of customers to gain access to the transmission services necessary to reach competing suppliers became increasingly important." Id. at 33,062. Yet the owners of transmission lines, the traditional utilities that had built the high-cost generation capacity, denied alternative producers access to their transmission lines on competitive terms and conditions. FERC therefore began requiring utilities to file open access transmission tariffs that permitted other suppliers to transmit power over [Page 9] their lines under certain circumstances, such as when a utility sought authorization to merge with another utility or to sell power at market-based rather than cost-based rates.

Then, in 1992, Congress enacted the Energy Policy Act, which amended sections 211 and 212 of the FPA to authorize FERC to order utilities to "wheel" power—i.e., transmit

power for Wholesale sellers of power over the utilities' transmission lines—on a case-by-case basis. Pub. L. No. 102-486, 106 Stat. 2776, 2915-16 (1992) (codified at 16 U.S.C. §§ 824j-k). FERC "aggressively implemented" amended sections 211 and 212 to "'facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.'" Open Access NOPR, ¶ 32,514 at 33,064 (quoting Notice of Proposed Rulemaking, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,507 at 32,866, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR")).

Despite these efforts, a persistent barrier to the development of a competitive wholesale power sale market remained. The Commission found that "utilities owning or controlling transmission facilities possess substantial market power, that, as profit maximizing firms, they have and will continue to exercise that market power in order to maintain and increase market share, and will thus deny their wholesale customers access to competitively priced electric generation; and that these unduly discriminatory practices will deny consumers the substantial benefits of lower electricity prices." Open Access NOPR, ¶ 32,514 at 33,052. Power generators not permitted to use utilities' transmission lines on reasonable terms have no way to transmit their power to customers.

Invoking its authority under sections 205 and 206 of the FPA to remedy unduly discriminatory or preferential rules, regulations, practices, or contracts affecting public utility rates for transmission in interstate commerce, 16 U.S.C. §§ 824d-e, and building on its experience in restructuring the natural gas industry, see Associated Gas Distribs. v. FERC, 824 F.2d 981 (D.C. Cir. 1987), the Commission issued Orders [Page 10] 888 and 889 to "prevent this discrimination by requiring all public utilities owning and/or controlling

transmission facilities to offer non-discriminatory open access transmission service." Open Access NOPR, ¶ 32,514 at 33,052. Orders 888 and 889 mandate what FERC terms "functional unbundling," i.e., separating utilities' wholesale transmission functions from their wholesale electricity merchant functions. Specifically, the orders require utilities to (1) file open access nondiscriminatory tariffs that contain the minimum terms and conditions of nondiscriminatory services prescribed by FERC through its pro forma tariff; (2) take transmission service for their own new Wholesale sales and purchases of electric energy under the same terms and conditions as they offer that service to others; (3) develop and maintain a same-time information system that will give potential and existing transmission users the same access to transmission information that the utility enjoys (called the "Open Access Same-Time Information System" or "OASIS"); and (4) state separate rates for wholesale generation, transmission, and ancillary services. See Order 888, ¶ 31,036 at 31,635-36.

In requiring utilities to provide open access transmission, FERC acknowledged the dramatic change the orders would bring about, explaining that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rule-making is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. Known as "stranded costs," these "uneconomic sunk costs" are costs that utilities incurred not only with regulatory approval, but with the expectation of continuing to serve their current customers. These costs will become "stranded" when customers take advantage of open access transmission to purchase cheaper power from suppliers other than their historic utilities. Order 888 affords utilities an opportunity to recover stranded costs from their wholesale requirements customers, but only from those customers who use their utility's transmission service to

purchase power from new suppliers, and only if the utility can [Page 11] prove that it had a reasonable expectation of continued service to that customer.

After three rehearing orders, the Commission denied any further rehearing. All petitions for review of Orders 888 and 889 were consolidated and transferred to this circuit. We consider these petitions in this opinion. Section II considers challenges to FERC's authority to require utilities to file open access tariffs as a remedy for undue discrimination. Section III evaluates FERC's conclusion that it lacked jurisdiction to order retail unbundling yet has jurisdiction over transmission where state commissions have unbundled retail sales. Section IV addresses FERC's authority to require nonpublic utilities to provide reciprocal open access transmission service. Section V considers challenges to Order 888's stranded cost recovery provisions. Section VI evaluates petitioners' arguments relating to credits for customer-owned facilities and behind-the-meter generation. Section VII addresses discounting interface allocation, and liability. Section VII evaluates other arguments relating to the terms and conditions of the pro forma tariff. Section IX assesses FERC's compliance with the National Environmental Policy Act and the Regulatory Flexibility Act.

In the end, we affirm the orders in all respects except two: we remand for FERC to explain its treatment of energy costs in the stranded cost market option (Section V.A.5.c) and to provide a reasonable cap on contract extensions under existing customers' right-of-first-refusal (Section VIII.E).

II. FERC'S AUTHORITY TO REQUIRE OPEN ACCESS

Although FERC asserts that "mounting claims of undue discrimination in transmission access" prompted its movement toward open access, the open access requirement of Order 888 is premised not on individualized findings of discrimination by specific transmission providers, but on FERC's identification of a fundamental systemic problem in

the industry. Generally, those entities that own or control interstate transmission facilities are vertically-integrated public utilities that also generate and sell electricity. In its 1995 [Page 12] notice of proposed rulemaking, FERC observed that there were at that time approximately 328 public utilities, marketers, and wholesale generation entities with transmission needs, and that approximately 137 of those owned or controlled the transmission facilities. See Open Access NOPR, ¶ 32,514 at 33,051. Entry into the transmission market is difficult and restricted, so those utilities that already own transmission facilities enjoy a natural monopoly over that field. The transmission-owning utilities can use their position to favor their own generated electricity and to exclude competitors from the market, whether by denying transmission access outright, or by providing transmission services to competitors only at comparatively unfavorable rates, terms, and conditions. Utilities that own or control transmission facilities naturally wish to maximize profit. The transmission-owning utilities thus can be expected to act in their own interest to maintain their monopoly and to use that position to retain or expand the market share for their own generated electricity, even if they do so at the expense of lower-cost generation companies and consumers.

Even before Order 888, some transmission-owning utilities voluntarily opened their transmission facilities to third party suppliers and purchasers of electricity; and FPA § 211 explicitly gives FERC the authority to order involuntary wheeling on a case-by-case basis. The Commission decided, however, that relying upon voluntary arrangements and § 211 orders would not remedy the fundamentally anti-competitive structure of the transmission industry. Instead, the Commission concluded, such a piecemeal approach would result in an inefficient "patchwork" of transmission systems nationwide. "The ultimate loser in such a regime is the consumer." Open Access NOPR, ¶ 32,514 at 33,071.

As an alternative, the Commission interpreted the anti-discrimination language of FPA §§ 205 and 206, 16 U.S.C. §§ 824d, 824e (1994), as giving it the authority to impose open access as a generic remedy for its findings of systemic anti—competitive behavior. Invoking that broad authority, in Order 888, FERC requires every transmission-owning public utility within FERC's jurisdiction to file an Open Access [Page 13] Transmission Tariff (OATT) containing minimum terms and conditions for non-discriminatory service and to take transmission service for their own wholesale sales and purchases of electric energy under those filed OATTs. In other words, this order requires the public utilities to provide the same transmission services to anyone purchasing or selling wholesale power—other public utilities, federal power suppliers and marketers, municipalities, cooperatives, independent power producers, qualifying facilities, or power marketers—as they provide to themselves. The Board of Water, Light and Sinking Fund Commissioners of the City of Dalton (Dalton) operates a municipally-owned utility system which provides electric power to residential, commercial, and industrial consumers in the city of Dalton, Georgia. Dalton obtains transmission services from the Georgia Integrated Transmission System (ITS), which it owns along with public utility George Power Company (GPC) and two other utilities that are not subject to FERC's jurisdiction, and which GPC operates according to the terms of various filed agreements. Puget Sound Energy, Inc. (Puget) is a public utility in the Pacific Northwest, where Bonneville Power Administration, which is not a public utility subject to Order 888's requirements,[3] [Page 14]

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[3] Bonneville Power Administration (BPA) "is a power marketing agency in the Pacific Northwest that markets power from thirty federal hydroelectric projects constructed and operated by the Corps of Engineers and the Bureau of Reclamation." In re Bonneville Power Administration, Power Sale and Transmission Rates, 54 F.E.R.C. ¶ 62,143 (1991). In Order 888, FERC concluded that BPA is not a public utility as defined by Federal Power Act (FPA) § 201(e), and thus is not subject to Order 888's

dominates the electricity transmission market. These two industry petitioners challenge the open access requirement of Order 888 on various statutory, constitutional, and other grounds.

Turning first to the FPA itself, Puget and Dalton argue that §§ 205 and 206 do not give the Commission the authority to order open access as a generic remedy; and even if the FPA does give the agency such authority, FERC has failed to satisfy the statutory requirements for invoking it. Dalton also argues that Order 888 itself violates the FPA by discriminating against transmission facility owners who have invested in those assets. Shifting to constitutional concerns, Puget and Dalton, along with amicus curiae Pacific Legal Foundation, maintain that Order 888 violates the Takings Clause of the Fifth Amendment. Finally, Dalton argues that the open access requirements of the OATT interfere with the antitrust conditions of outstanding nuclear licenses, and thus are unlawful. While we consider each of these challenges separately,[4] we hold that Order 888's open access

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requirements. Order 888, ¶ 31,036 at 31,858. FERC admitted, however, to three circumstances under which it might review BPA's transmission access and pricing policies: (1) if BPA files an open access tariff for review and confirmation under the Northwest Power Act and asks FERC to find that the tariff meets FERC's open access policies; (2) to the extent that BPA "is a transmitting utility subject to a request for mandatory transmission services" under FPA § 211; and (3) to the extent that BPA receives open access transmission from a public utility and is thereby subject to the reciprocity provision in that public utility's pro-forma tariff. Id.

[4] The Commission and various intervenors on its behalf argue extensively against our jurisdiction over these issues on the grounds that the petitioners failed, in various ways, adequately to raise their concerns before the agency and to preserve the issues for judicial review. Upon careful review of the record, we can safely conclude without further elaboration that these jurisdictional arguments are without merit, that the Commission has had ample notice and opportunity to address all of the petitioners' various statutory, constitutional, and other challenges to

requirement is authorized by and consistent with the FPA and the Takings Clause. We conclude also that Dalton has not yet suffered injury from the alleged conflict between open access and the nuclear license antitrust conditions, and that its complaint on that issue is therefore not yet ripe for judicial review.

A. Statutory Challenges: FPA §§ 205 and 206

Section 205 of the FPA broadly precludes public utilities, in any transmission or sale subject to FERC's jurisdiction, from "mak[ing] or grant[ing] any undue preference or advantage to [Page 15] any person or subject[ing] any person to any undue prejudice or disadvantage . . . ." 16 U.S.C. § 824d(b). Section 206 of the FPA further provides in relevant part that

> [w]henever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

16 U.S.C. § 824e(a). The statutory issues before us are whether these provisions give FERC the authority to order involuntary wheeling as a generic remedy, and if they do, whether FERC satisfied the procedural and evidentiary requirements imposed by these provisions.

Order 888's open access requirement, and that we have jurisdiction to consider these issues.

1. §§ 205 and 206 and Otter Tail Power Company

The Commission did not write on a blank slate when it interpreted FPA §§ 205 and 206 as giving it the authority to order involuntary wheeling as a generic remedy for systemic anti-competitive behavior. Puget and Dalton argue principally that the Supreme Court's decision in Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), controls the disposition of this issue. Otter Tail was an antitrust case in which the Supreme Court addressed whether the district court could require Otter Tail Power Company to wheel power for its competitors as a remedy for monopolistic practices. Contrary to the company's arguments, the Supreme Court concluded that the district court's order did not impermissibly conflict with the authority of the Federal Power Commission, FERC's predecessor, because the agency did not have the power itself to order involuntary wheeling under Part II of the FPA, which includes §§ 205 and 206. Puget and Dalton [Page 16] cite various circuit court precedents, including one from this circuit, as construing Otter Tail to prevent the Commission from ordering involuntary wheeling as a generic remedy. See, e.g., Florida Power & Light Co. v. FERC, 660 F.2d 668 (5th Cir. Unit B Nov. 1981); New York State Electric & Gas Corp. v. FERC, 638 F.2d 388 (2d Cir. 1980); Richmond Power & Light v. FERC, 574 F.2d 610 (D.C. Cir. 1978). Finally, Puget and Dalton note that subsequent to Otter Tail, Congress enacted FPA § 211, 16 U.S.C. § 824j, giving FERC the authority to impose open access on a case-by-case basis to remedy a broad range of problems. The petitioners argue that, if FPA §§ 205 and 206 authorize the Commission to impose open access, and if Otter Tail does not prohibit such action, then there was no reason for Congress to enact § 211.

In response, the Commission contends that we should not read Otter Tail as limiting its authority under FPA § 206 to remedy discriminatory behavior, since Otter Tail was an antitrust case and not an undue discrimination case. The

Commission also maintains that the circuit court cases cited by the petitioners are not on point and do not prohibit a generic open access remedy. The Commission points instead to our decision in Associated Gas Distributors v. FERC, 824 F.2d 981, 998 (D.C. Cir. 1987) (AGD), in which we upheld a similar open access transportation requirement imposed by FERC on natural gas transmission, as the controlling precedent. Finally, FERC argues that Congress enacted FPA § 211 to broaden its already existing authority to order involuntary wheeling, as FPA §§ 205 and 206 authorize such action only as a remedy for undue discrimination.

We agree with FERC that our decision in AGD controls the disposition of this issue. In AGD, we reviewed a FERC order imposing open access conditions on pipelines transporting natural gas. See 824 F.2d at 997-1001. Considering arguments quite similar to those made by the petitioners here, we concluded that Otter Tail does not constrain FERC from mandating open access where it finds circumstances of undue discrimination to exist. See id. at 998-99. Turning to relevant circuit precedent, we construed Richmond Power & Light as supporting only the proposition that a refusal to [Page 17] provide transmission services to another utility was not per se unduly discriminatory and we noted that the court in Florida Power & Light expressly left open the question of whether FERC could impose open access conditions as a remedy for anti-competitive behavior. See id. at 999. Further, we pointed out that our reading of Richmond is consistent with other precedent, specifically Central Iowa Power Coop. v. FERC, 606 F.2d. 1156 (D.C. Cir. 1979), in which we upheld FERC's use of its authority to prevent undue discrimination to condition its approval of a power-pooling agreement upon removal of membership criteria which denied certain privileges to some but not all participants. See AGD, 824 F.2d at 999. Indeed, in AGD, we noted that open access relies upon the very same principles that we upheld in Central Iowa. See id. Although AGD addressed open access under the anti-discrimination

provisions of the Natural Gas Act (NGA) rather than FPA §§ 205 and 206, we have repeatedly recognized the similarity of the two statutes and held that they should be interpreted consistently. See Environmental Action v. FERC, 996 F. 2d 401, 410 (D.C. Cir. 1993); Tennessee Gas Pipeline Co. v. FERC, 860 F.2d 446, 454 (D.C. Cir. 1988); see also Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981). Thus, AGD counsels the conclusion that, while Otter Tail may represent a general rule that FERC's authority to order open access is limited, the FPA, like the NGA, makes an exception to that rule where FERC finds undue discrimination.

Moreover, as in AGD, the deferential standard of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), governs our review of FERC's interpretation of FPA §§ 205 and 206. See AGD, 824 F.2d at 1001. If we agreed with Puget and Dalton that the Supreme Court's Otter Tail opinion dictates a particular construction of §§ 205 and 206, then the Commission's contrary interpretation would not be entitled to Chevron deference. See Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of stare decisis, and we judge an agency's later interpretation of the statute against [Page 18] our prior determination of the statute's meaning."). But having concluded that Otter Tail does not govern the disposition of this case, we are faced solely with considering the validity of FERC's interpretation of the FPA, a statute that the Commission administers. In AGD, we concluded that FERC reasonably interpreted the NGA's ambiguous anti-discrimination provisions as giving it broad authority to remedy unduly discriminatory behavior through a generic open access requirement. See AGD, 824 F.2d at 1001. Given the FPA's similar language, we can only reach the same conclusion with respect to Order 888. For all of these reasons, we find that the Commission has the

authority under FPA §§ 205 and 206 to require open access as a generic remedy to prevent undue discrimination.

2. § 206(a) Procedural and Evidentiary Requirements

Puget and Dalton next argue that, even if FPA §§ 205 and 206 authorize FERC to impose open access generically, § 206(a) imposes certain procedural and evidentiary requirements for action which the Commission failed in two separate but related ways to satisfy. First, the petitioners claim that FPA § 206(a) requires substantial evidence of contemporaneous "unjust, unreasonable, unduly discriminatory or preferential" behavior before the Commission can act. The Commission made no finding of discrimination or monopoly control on the part of Georgia Power Company or Puget. None of the applications or complaints filed with the Commission accused these petitioners of unduly discriminatory or anti-competitive behavior. Instead, the Commission premised Order 888 on a generic finding that public utility holders as a group have sufficient monopoly power over the transmission of electricity to engage in unduly discriminatory and anti-competitive practices, and that this condition will worsen in the future. To support its finding, the Commission relied upon unsubstantiated allegations of discriminatory conduct in public comments, its own experience in reviewing applications and complaints, and its own understanding of the incentives for monopolists to behave discriminatorily.

[Page 19] Puget and Dalton additionally assert that FPA § 206(a) requires that the requisite findings of undue discrimination be made in the context of a hearing. Although they concede that a rulemaking proceeding can satisfy the statute's hearing requirement, Puget and Dalton maintain that the rulemaking proceeding nevertheless must clearly identify the challenged activities and actors, and give the accused actors the opportunity to demonstrate that their activities were not unlawful. The petitioners protest that the

Commission's notice-and-comment rulemaking process did not afford them such opportunity.

FERC claims the discretion under NLRB v. Bell Aerospace Co., 416 U.S. 267, 293 (1974), to choose between rulemaking and case-by-case adjudication; and FERC contends that its generic rulemaking process fully satisfied the requirements of FPA § 206(a). FERC concedes that it relied upon general findings of systemic monopoly conditions and the resulting potential for anti-competitive behavior, rather than evidence of monopoly and undue discrimination on the part of individual utilities. Citing our opinion in Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1166 (D.C. Cir. 1985), however, FERC maintains that such findings are sufficient to substantiate its decision to impose the open access requirement. Finally, FERC observes that we rejected these same arguments in AGD. See 824 F.2d at 1008 (citing Wisconsin Gas, 770 F.2d at 1165-68).

Again, we must agree with the Commission. In American Public Gas Ass'n v. FPC, we held that the Commission could exercise its authority under NGA § 5(a), the provision parallel to FPA § 206, through rulemaking as well as adjudication. See 567 F.2d 1016, 1064-67 (D.C. Cir. 1977); See also Wisconsin Gas, 770 F.2d at 1153 (articulating the American Public Gas holding). Congress subsequently ratified the American Public Gas holding when it enacted the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1994). See Wisconsin Gas, 770 F.2d at 1153 n.8 (acknowledging the Act). That statute provides that "the establishment of rates and charges under the Federal Power Act [16 U.S.C. 791a et seq.] or the Natural Gas Act [15 U.S.C. 717 et seq.], may be conducted by [Page 20] rule making procedures." 42 U.S.C. § 7173(c) (brackets in original). By passing a statute adopting the holding of American Public Gas, and explicitly applying that rule to the FPA as well as the NGA, Congress signaled its intent that the

hearing requirements of NGA § 5(a) and FPA § 206(a) be interpreted similarly.

Interpreting the hearing requirement of NGA § 5(a), we have said that, while the Commission cannot rely solely on "unsupported or abstract allegations," the agency is also not required to make "specific findings," so long as the agency's factual determinations are reasonable. See Wisconsin Gas, 770 F.2d at 1158. In AGD, we applied Wisconsin Gas in holding that the Commission was not required to make specific findings that individual rates charged by individual pipelines were unlawful, or to offer empirical proof for all the propositions upon which its order depended, before promulgating a generic rule to eliminate undue discrimination. See AGD, 824 F.2d at 1008-09. Upon comparison of the order considered in AGD with Order 888, if anything, FERC more thoroughly documented the reasons for its actions in Order 888 than in the earlier natural gas order.

Puget claims that AGD and Wisconsin Gas are distinguishable, and that this case is governed by Electricity Consumers Resource Council v. FERC, 747 F.2d 1511 (D.C. Cir. 1984), in which we reversed FERC's adoption of a rate based on an economic theory in the absence of a discussion of the practical applications of that theory. See 747 F.2d at 1514. As the AGD court recognized, however, the court in Electricity Consumers was persuaded that the Commission had distorted the economic theory it claimed to apply. See AGD, 824 F.2d at 1008. Just as the pipelines in AGD did, Puget has failed to articulate exactly how FERC has distorted the theories on which it relies in Order 888. Additionally, the AGD court rejected the idea that "Electricity Consumer's reference to 'economic theory' was intended to invalidate agency reliance on generic factual predictions merely because they are typically studied in the field called economics." Id. Following the rationale of Wisconsin Gas

and AGD, we conclude that [Page 21] FERC has satisfied the requirements for invoking its authority under FPA § 206(a).

3. Discriminatory Effect of Order 888

Dalton charges that, even if the FPA permits FERC to impose involuntary wheeling generally, the open access requirement of Order 888 causes rather than remedies discrimination, and therefore violates FPA § 206(a)'s express requirement that FERC act against undue discrimination. Specifically, Dalton and the other non-jurisdictional owners of the Georgia ITS facilities invested millions of dollars in those facilities in order to use the facilities each owns and receive reciprocal open access transmission services from the other owners. Under the Open Access Transmission Tariff (OATT), other customers do not have to make such investments to use the Georgia ITS facilities. FERC responds that Order 888 does not unduly discriminate between old and new customers of integrated transmission systems like the Georgia ITS; and that if Dalton has evidence that the tariff results in undue discrimination in its individual circumstances, Dalton remains free to file a petition under FPA § 206 for redress, and FERC will consider its claim.

FERC's conclusion that its open access requirement is not unduly discriminatory is subject only to arbitrary and capricious review. See 5 U.S.C. § 706(2)(A) (1994); Sithe/Independence Power Partners, LP v. FERC, 165 F.3d 944, 948 (D.C. Cir. 1999); Union Pacific Fuels, Inc. v. FERC, 129 F.3d 157, 161 (D.C. Cir. 1997). We conclude that FERC has adequately explained why its open access requirement is not unduly discriminatory. Relying upon extensive commentary as well as its own experiences, FERC concluded that, as a general matter, transmission industry conditions were conducive to discriminatory practices and anti—competitive behavior, such that case-by-case adjudication could not adequately address the problem. FERC also recognized that its generic findings may have exceptions, and thus that Order 888 may in individual

circumstances have a different result than that intended. Therefore, Order 888 does not preclude facilities owners the opportunity to argue their particular circum-[Page 22]stances in their OATT filings or, as with Dalton, in their own petitions for relief under FPA § 206(a). Rather, Order 888 merely shifts from a regulatory norm in which a user of transmission services must demonstrate to FERC an individualized need for open access to one in which a provider of transmission services must present to FERC individualized circumstances requiring relief from open access. As the petitioners have a mechanism by which they can seek relief for their particular concerns, we find nothing arbitrary or capricious about FERC's conclusion that its approach to open access is not unduly discriminatory.

In another stab at demonstrating the discriminatory effect of Order 888's open access requirement, Dalton alerts us to an agreement entered into between it and Georgia Power Company (GPC) in partial implementation of antitrust conditions contained in operating licenses issued by the Nuclear Regulatory Commission for jointly owned nuclear facilities connected to the Georgia ITS. Those antitrust conditions require GPC to provide Dalton with transmission services until the nuclear licenses expire, long after the ITS Agreement terminates. Dalton alleges that limitations imposed by Order 888 on Dalton's rights upon termination of the ITS Agreement are inconsistent with GPC's obligations under the nuclear licenses, and that the interference will result in discrimination against Dalton. FERC maintains that it agreed in addressing GPC's Order 888 compliance filing to treat the ITS Agreements separately.

Ultimately, Dalton has offered no present injury from the alleged conflict, so this issue is not ripe for review. Dalton will only be injured if, upon termination of the ITS Agreement, Order 888 interferes with Dalton's right to transmission services. Dalton's own argument suggests as much, observing that FERC "left to GPC the decision

whether it 'must, but cannot, comply with separate orders' of NRC and FERC and whether it will present evidence of such conflict to either Commission," and complaining that even if GPC does act, "the orders under review provide no assurance that the competitive transmission and other service rights provided by the nuclear licenses will be respected under the OATT." Br. [Page 23]of Petitioner Dalton at 23 (quoting Order 888-A, ¶ 41,048 at 30,452). In short, GPC and FERC are still in the process of determining whether the antitrust provisions even conflict with Order 888, as well as how to deal with any such inconsistency.[5] Accordingly, this issue is not appropriate for judicial review at this time.

B. Constitutional Challenge: Fifth Amendment Takings Clause

Puget and amicus curiae Pacific Legal Foundation (Pacific) contend that Order 888 violates the Takings Clause of the Fifth Amendment. These petitioners maintain that Order 888's open access requirement engineers a "taking" in two ways: First, that FERC's open access requirement effects a regulatory taking by arbitrarily changing pricing methodology in a way that excessively deprives transmission owners of their investments in facilities; and, second, that the open access requirement allows a physical invasion, a permanent physical occupation, by taking away the transmission owners' right to exclude competitors from their transmission property. We cannot grant relief on either ground.

When the action of the federal government effects a "taking" for Fifth Amendment purposes, there is no inherent constitutional defect, provided just compensation is available. At bottom, both of the petitioners' Fifth Amendment claims turn not on whether open access effects a taking, but whether

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[5] GPC's management of the Georgia ITS is subject to the direction of a committee that includes Dalton representatives.

FERC's cost-based transmission pricing policies in the end provide just compensation. The remedy of just compensation is not within our jurisdiction but that of the United States Court of Federal Claims, under the Tucker Act, 28 U.S.C. § 1491. See Bell Atlantic Tel. Cos. v. Federal Communications Comm'n, 24 F.3d 1441, 1444 n.1 (D.C. Cir. 1994); Railway Labor Executives' Ass'n v. United States, 987 F.2d 806, 815-16 (D.C. Cir. 1993).

We recognize that our jurisdiction to review an agency's construction of a statute necessarily involves an exercise of [Page 24]the policy of avoiding constitutional issues where possible, even though the issues may concern arguable takings amenable to Tucker Act remedy, "when 'there is an identifiable class of cases in which application of a statute will necessarily constitute a taking.'" Bell Atlantic, 24 F.3d at 1445 (D.C. Cir. 1994) (quoting United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 128 n.5 (1985)). We need not decide whether this case falls within that category, however, because even if it did, any takings problem created by Order 888 does not raise such significant constitutional doubt as to require us to construe the FPA to prohibit FERC from ordering open access. If there is a taking, and a claim for just compensation, then that is a Tucker Act matter to be pursued in the Court of Federal Claims, and not before us.

III. FEDERAL VERSUS STATE JURISDICTION OVER TRANSMISSION SERVICES

Vertically integrated utilities use their own facilities to generate, transmit, and distribute electricity to their customers. Traditionally, the customer paid one combined rate for both the power and its delivery, thus the industry refers to such sales as "bundled." To thc extent that bundled sales are made directly to the end user of the electricity, they are also recognized as retail sales. Utilities may also sell the electricity they generate at wholesale to other utilities or other resellers of power, which then resell that power to their own customers. Thus, the same utility may use its facilities

to serve both retail and wholesale customers. Vertically integrated utilities use their transmission facilities to move electricity over long distances, and use local distribution lines to deliver the electricity to the end user.

Even before Congress enacted the FPA, the Supreme Court held that states could not regulate wholesale sales of electricity. See Public Utils. Comm'n of R.I. v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927). A few years later in 1935, Congress included in the FPA a provision giving the Federal Power Commission, FERC's predecessor agency, the authority to regulate "the sale of [electric] energy at whole-[Page 25]sale," as well as "the transmission of electric energy in interstate commerce." FPA § 201(a), 16 U.S.C. § 824(a) (1994). FERC also limited federal regulation "to those matters which are not subject to regulation by the States," id., and reserved to the states "jurisdiction ... over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce...." FPA § 201(b), 16 U.S.C. § 824(b). Pursuant to these provisions, FERC has regulated wholesale power sales and interstate transmissions, and state agencies have retained jurisdiction over bundled retail transactions, including service issues and the intrastate sale and distribution of electricity through local distribution facilities.

Initially, as most transactions involved either a wholesale or a retail sale, and correspondingly transmission or local distribution facilities, this regulatory division of labor was straight-forward in application. Indeed, in 1935, when Congress enacted the FPA, the networks of high-voltage, long-distance transmission lines which today crisscross the United States did not exist. Instead, vertically integrated utilities individually built facilities sufficient to meet the power needs of their customers. Over time, however, the landscape of the electric industry changed.

Utilities decided to cover demand spikes by sharing power, rather than by building more generation capacity. The transmission grid developed from these arrangements. Eventually, nonutility generators started producing electricity; and power marketers began to buy and resell electricity to other power marketers, utilities, or even directly to consumers. These industry participants do not own transmission lines, so they rely upon the utilities that own such facilities to provide transmission services. In addition to their traditional bundled sales activity, vertically integrated utilities started "unbundling" their own services and developing their own power marketing units to buy and sell electricity at wholesale. Some states even mandate unbundling of retail services. As a result of these changes, facilities once used solely for local distribution of bundled retail sales now engage regularly in [Page 26]unbundled wholesale transmissions and retail delivery as well. Thus, while the electricity world once neatly divided into spheres of retail versus wholesale sales and local distribution versus transmission facilities, such is no longer the case.

In Order 888, FERC reinterpreted FPA § 201 to accommodate the new industry practices and conditions. FERC left the regulation of bundled retail transmissions to the states, concluding that "when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail." Order 888, ¶ 31,036 at 31,781. Nevertheless, FERC asserted jurisdiction over all unbundled retail transmissions, and left to the states only the sales portion of unbundled retail transactions, on the ground that FPA § 201 gives it jurisdiction without qualification over all transmission by public utilities in interstate commerce. See id. Also, while acknowledging that FPA § 201(b) explicitly places retail transmissions by "facilities used in local distribution" beyond the Commission's jurisdiction, FERC adopted a seven factor jurisdictional test for determining which facilities fall within that category, and claimed exclusive authority over those that

do not. See id. at 31,780, 31,784. In the present litigation, each of these changes is challenged, with some petitioners claiming that FERC went too far, and others contending that the Commission did not go far enough in asserting jurisdiction.

A. Bundled Retail Sales

Several state regulatory commissions complain that FERC exceeded the boundaries of its statutory authority by asserting jurisdiction over unbundled retail transmissions. These state petitioners argue that the plain meaning and history of FPA § 201(a) gives FERC the authority to regulate only transmissions of electricity consumed in a state other than that in which the electricity was generated, if the transmission was not otherwise subject to state regulation. The states historically have regulated retail transmissions as part of bundled retail sales of electricity, while FERC has regulated wholesale transmissions; and the division of regulatory jurisdiction should not change merely because those transac-[Page 27]tions have now been unbundled into separate generation, transmission, and sales components.

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the "unbundling and discounting" or "U&D" petitioners), both intervene on the side of FERC with respect to the states' claim, and separately challenge FERC's interpretation of its jurisdiction on different grounds. The U&D petitioners contend that FERC impermissibly limited its jurisdiction by leaving the regulation of bundled retail transmissions to the states. These parties maintain that FERC has the authority to regulate both bundled and unbundled retail transmissions, and that FERC violates FPA § 206 by limiting the scope of Order 888 to the latter. To establish that bulk transmission by utilities is transmission in interstate commerce regardless of whether the power is sold at wholesale or retail, the U&D petitioners cite particularly FPC v. Florida Power & Light

Co., 404 U.S. 453 (1972), and Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943), two of the cases relied upon by FERC in the Notice of Proposed Rulemaking, ¶ 32,514 at 33,135-42. As further support that FERC's jurisdiction extends to all interstate transmissions, the U&D petitioners offer NGA precedent recognizing FERC's authority over all interstate gas transportation, if not the gas being transported. See, e.g. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 636 (1972); United Distribution Cos. v. FERC, 88 F.3d 1105, 1153 (D.C. Cir. 1996) (UDC); Mississippi River Transmission Corp. v. FERC, 969. F.2d 1215 (D.C. Cir. 1992). These petitioners contend that excluding bundled retail transmissions from the OATT will permit discrimination and give owners a competitive advantage, contrary to the mandate of FPA § 206(a) that FERC eliminate undue discrimination. Accordingly, the U&D petitioners claim that FERC erred when it declined to mandate functional unbundling for an owner's transmissions to bundled retail customers of (1) its own generated power or (2) power purchased at wholesale.

In response to these challenges, FERC maintains that the plain meaning of FPA § 201 gives the Commission jurisdic-[Page 28]tion over all interstate transmissions without qualification, while at the same time limiting jurisdiction over sales to wholesale sales. Relying particularly on Florida Power & Light and Jersey Central Power & Light, FERC asserts broad jurisdiction over all transmission activities in interstate commerce. As for bundled retail sales, FERC's position is that once the transmission service is bundled with generation and local distribution, it becomes merely a component of the retail sale itself, over which FERC has no jurisdiction. FERC maintains that natural gas jurisprudence is inapplicable because the language of the NGA and FPA differ on this issue, and the natural gas cases turned on the existence of a regulatory gap that does not exist in the electricity field. FERC also asserts that its interpretation of the FPA's jurisdictional grant is entitled to deference under

Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U. S. 837 (1984).

Both FPA § 201(a) and (b) clearly and unambiguously confer upon FERC jurisdiction over the "transmission of electric energy in interstate commerce." FPA § 201(c) further provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof." 16 U.S.C. § 824(c). In both Florida Power & Light and Jersey Central Power & Light, the Supreme Court considered whether certain indirect transmissions of electrical power across state lines represented transmissions in interstate commerce.

Jersey Central Power & Light involved the transmission of energy generated by Jersey Central in New Jersey. Jersey Central transmitted electricity to the New Jersey transmission facilities of another company, Public Service, which then transmitted the power first to another of its New Jersey facilities, and then on to a facility owned by yet a third company and located in the middle of a body of water separating New Jersey from Staten Island, New York. The third company in the chain then transmitted the energy first to its own facilities in New York, then finally and ultimately to consumers in New York. Jersey Central's own transmission facilities were located solely in New Jersey, and as were [Page 29]the facilities used by Public Service to receive the transmissions from Jersey Central.

The Supreme Court recognized that Jersey Central had no control over the transmissions' destination once the electricity was delivered to Public Service, see Jersey Central, 319 U.S. at 65, and that the total flow of electricity from Jersey Central to New York was small. See id. at 66. Nevertheless, because some electricity generated by Jersey Central in New Jersey was consumed in New York, the Court upheld FERC's jurisdiction under FPA § 20l, over Jersey Central's transmission facilities as utilized for transmissions in interstate's commerce. See id. at 67. The Court said that,

under FPA § 201(a) and (b), FERC's power extends over all facilities "which transmit energy actually moving in interstate commerce." Id at 72. The Court emphasized, however, that "mere connection" of one utility's transmission facilities to those of another transmitting in interstate commerce was insufficient for jurisdiction under FPA § 201. Id.

The Court revisited the issue in Florida Power & Light, which involved certain Florida and Georgia utilities who voluntarily connected their transmission facilities to coordinate their activities and exchange power as required to meet temporary needs. Like Jersey Central, FP&L's transmission facilities were confined to Florida, and none of FP&L's transmission lines directly connected with those of out-of-state companies. Nevertheless, because FP&L was a member of a group of interconnected utilities, its transmission lines connected with those of other Florida utilities; and the lines of one of those other utilities, Florida Power Corp., interconnected just short of Florida's northern border with those of Georgia Power Co. Records indicated that power transfers between FP&L and Florida Power coincided with transfers between Florida Power and Georgia Power.

In Jersey Central, logs of the relevant companies demonstrated at least a dozen occasions when facilities in New York drew power from certain lines at times when Jersey Central was the only supplier of electricity to those lines. See Florida Power & Light, 404 U.S. at 459. By way of contrast, [Page 30] there was no similar evidence that power generated by FP&L specifically passed through Florida Power to Georgia Power, with Florida Power serving as a mere conduit. See id. At best, company records demonstrated instances when transfers between FP&L and Florida Power occurred at or about the same time as transfers between Florida Power and Georgia Power. See id. at 457.

Instead, the Court considered two theories by which FP&L's power could be deemed transmitted across state lines. The first posited a cause and effect relationship by which every flick of a light switch would cause every generator on a multi-state interconnected system to produce some quantity of additional electricity to maintain the system's balance, and thus to transmit electric energy throughout the system and across state lines. The second theory suggested that where the transmission lines of two utilities interconnect, their energy commingles, such that inevitably some energy transmitted by FP&L to Florida Power was then transmitted to Georgia Power and across state lines.

Despite its statement in Jersey Central that "mere connection determines nothing," 319 U.S. at 72, the Court relied on the second of these theories to conclude that FP&L facilities were transmitting energy in interstate commerce, and left open the possible validity of the cause and effect theory. See 404 U.S. at 462-63. Writing in dissent, Justice Douglas characterized the Court's opinion as "mean[ing] that every privately owned interconnected facility in the United States...is within the [Federal Power Commission's] jurisdiction," such that otherwise local utilities would now be subject to the mandates of the federal bureaucracy. Id. at 471 (Douglas, J., dissenting).

The Supreme Court has interpreted the language in FPA § 201 regarding FERC's jurisdiction over transmissions in interstate commerce. We are bound by the High Court's dictates to conclude that the FPA gives FERC the authority to regulate transmissions at issue here, whether retail or wholesale. Even if the Court had not so spoken, however, and even if we independently concluded that the statute's text [Page 31]was less than clear, it is the law of this circuit that the deferential standard of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), applies to an agency's interpretation of its own statutory jurisdiction.

See Oklahoma Natural Gas Co. v. FERC, 28 F.3d 1281, 1283-84 (D.C. Cir. 1994). As guided by Chevron, unless Congress has directly spoken to the contrary, or FERC has unreasonably or impermissibly interpreted the statute, we must defer to the Commission's construction of ambiguous provisions of the FPA. See Chevron, 467 U.S. at 842-43. In this age of interconnected transmission grids, and given the accompanying technological complexities, we would be hard pressed to conclude that FERC's interpretation of § 201(c) as giving it jurisdiction over both wholesale and retail transmissions is unreasonable or impermissible.

Nevertheless, we are not persuaded that this conclusion requires FERC to mandate unbundling and assert jurisdiction overall retail transmissions. Just as FPA § 201 gives FERC jurisdiction over transmissions in interstate commerce and sales at wholesale, the statute also clearly contemplates state jurisdiction over local distribution facilities and retail sales. The statute is much less clear about exactly where the lines between those activities are to be drawn. A regulator could reasonably construe transmissions bundled with generation and delivery services and sold to a consumer for a single charge as either transmission services in interstate commerce or as an integral component of a retail sale. Yet FERC has jurisdiction over one, while the states have jurisdiction over the other. FERC's decision to characterize bundled transmissions as part of retail sales subject to state jurisdiction therefore represents a statutorily permissible policy choice to which we must also defer under Chevron. Accordingly, we affirm FERC's decisions in Order 888 to assert jurisdiction over unbundled retail transmissions while leaving regulation of bundled retail transmissions to the states.

B. Local Distribution Facilities

FPA §201(b) explicitly excludes from FERC jurisdiction "facilities used in local distribution or only for the transmis-[Page 32]sion of electric energy in intrastate commerce." 16

U.S.C. § 824(b)(1). Historically, wholesale sales have not for the most part involved local distribution facilities. FERC claims that increased unbundling gives resellers the opportunity to reconfigure the wholesale sales so that they might now occur on those facilities which traditionally have been treated as local distribution facilities. Moreover, FERC's assertion of jurisdiction over the transmission component of unbundled retail sales blurred the line between local distribution facilities and facilities used for transmission in interstate commerce.

In Order 888, FERC claimed exclusive authority over the regulation of facilities which sell and transmit electricity at wholesale to customers who will resell the electricity to end users. With respect to unbundled retail sales, FERC acknowledged that transmissions by "facilities used in local distribution" are beyond the Commission's jurisdiction, while facilities engaged in interstate transmission are subject to FERC jurisdiction under FPA § 201(a). Thus FERC adopted a seven factor jurisdictional test to identify whether a facility is a local distribution facility subject to state jurisdiction or a facility engaged in interstate transmission subject to FERC jurisdiction.[6] In short, under Order 888,

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[6] The Commission's seven factor test involves evaluating on a case-by-case basis whether the activities of the facilities in question correspond with seven specific indicators of local distribution:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographic area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.

Order 888, ¶ 31,036 at 31,981.

when a [Page 33]public utility is engaged in wholesale transmission, FERC has jurisdiction regardless of the nature of the facility; but when the public utility is engaged in unbundled retail transmission, the facts and circumstances will determine whether the facilities are subject to FERC or state jurisdiction.

The state petitioners argue that FERC's dual approach radically expands its jurisdiction and violates Congress' explicit directive in FPA § 201(b) that regulation of local distribution facilities be left to the states. The states contend that Congress clearly intended to preserve state jurisdiction over local distribution facilities, regardless of whether the energy comes from out of state or the sale is a wholesale sale. The states maintain that, by claiming jurisdiction over any facility transporting energy for resale, regardless of whether the facility might otherwise be a local distribution facility under the seven factor test, FERC has adopted the circular reasoning that wholesale sales do not occur on local distribution facilities, so any facility that engages in wholesale activities is not a local distribution facility. The states contend further that FERC offers no reasoned analysis of why local distribution should be defined differently for wholesale versus retail sales. The states finally charge that, under Order 888, nearly identical facilities would be under federal jurisdiction and state jurisdiction for different customers receiving indistinguishable service. Such a situation, they contend, will only encourage energy marketers to choose their regulator by using middlemen to shift the point at which title to the power transfers, and thus undermine the jurisdictional certainty that Order 888 states is necessary for competition.

FERC responds that it is not asserting jurisdiction over local distribution facilities, but assers that when a public utility delivers unbundled energy at wholesale to a supplier for the purpose of resale to an end user, FPA § 201 gives FERC unqualified authority to assert jurisdiction over the

facility used to effect that transaction. When the public utility is engaged in unbundled retail transmission, however, [Page 34] the circumstances of a specific case will determine whether the facilities used are subject to FERC or state jurisdiction. The arguments by the states do no more than raise policy concerns which are for FERC and not the court. See Arent v. Shalala, 70 F.3d 610 (D.C. Cir. 1995).

Intervening again on FERC's behalf on this issue, the U&D petitioners add that FERC's use of different tests is appropriate given the differences in the two separate jurisdictional grants of FPA § 201. The interveners argue that, given the statute's clear grant to FERC of jurisdiction over all aspects of wholesale sales FERC is fully justified in employing a functional test to identify wholesale transmissions. In contrast, because FERC's jurisdiction over retail sales is limited to transmissions in interstate commerce, the seven factor test is more appropriate.

We agree that FERC's dual approach to assessing its jurisdiction stems from the fact that FPA § 201 contains more than one jurisdictional grant. FPA § 201(b) denies FERC jurisdiction over local distribution facilities "except as specifically provided in this subchapter and subchapter III. 16 U.S.C. § 824(b)(1) (emphasis added). FPA § 201(a) makes clear that all aspects of wholesale sales are subject to federal regulation, regardless of the facilities used. FERC's assertion of jurisdiction over all wholesale transmissions, regardless of the nature of the facility, is clearly within the scope of its statutory authority. Moreover, various cases support the proposition that FERC regulates all aspects of wholesale transactions. See, e.g., Duke Power Co. v. FPC, 401 F.2d 930, 935-36 (D.C. Cir. 1968) (noting that the FPC regulates public utility facilities used in wholesale transmissions or sales in interstate commerce); Arkansas Power & Light Co. v. FPC, 368 F.2d 376, 383 (8th Cir. 1966) (stating that the functional use of the transmission lines—wholesale versus retail—controls); Wisconsin-

Michigan Power Co. v. FPC, 197 F.2d 472, 477 (7th Cir. 1952) (finding that transmission facilities used at wholesale are not "local distribution facilities").

[Page 35] The seven factor test applies only to unbundled retail sales, where FERC seeks to regulate pursuant to the separate grant of jurisdictional authority over transmissions in interstate commerce. In this context, the definition of "facilities used in local distribution" becomes relevant. The statute does not define "facilities used in local distribution," but instead leaves that task to FERC. As Chevron counsels us, FERC's interpretation of undefined and ambiguous statutory terms is entitled to deference. See Chevron, 467 U.S. at 842-43.

FERC has adopted a multi-factor test to determine the nature of transmission facilities. In a footnote, Order 888 says that distribution-only facilities which sell only at retail will still be considered local distribution facilities. See Order 888, ¶ 31,036 at 31,981 n.99. This is consistent with the fact that states historically have regulated bundled retail sales to end users. However, Order 888 implicitly recognizes the current reality that many primarily retail utilities engage in both local distribution and interstate transmissions, and seeks through the seven factors to discern each facility's primary function. We cannot agree with the state petitioners that this approach is unreasonable or otherwise impermissible.

IV. RECIPROCITY

Section 6 of the Tariff contains a reciprocity provision resting on the principle that any public utility offering "non-discriminatory open access transmission for the benefit of customers should be able to obtain the same non-discriminatory access in return." Order 888, ¶ 31,036 at 31,760. Non-public utilities—those outside the Commission's jurisdiction because, for instance, they are state-owned, see 16 U.S.C. § 824(f)—would otherwise not have to offer open-access. Under the Tariff, a public utility

does not have to offer them access unless they reciprocate. In order to avoid controversies between public and non-public utilities regarding reciprocal service, the Commission adopted a voluntary "safe harbor" provision pursuant to which non-public utilities could submit a transmission tariff to the Commission for a [Page 36]determination whether it satisfied the reciprocity condition. If it did, the public utility would have to offer service; if it did not, the public utility could refuse service (although it had the option of waiving the reciprocity condition, as did the Commission itself).

A. Indirect Regulation of Non-Jurisdictional Utilities

Nebraska Public Power District (NPPD), a state entity, provides electrical generation, transmission and distribution service to wholesale and retail customers throughout Nebraska.[7] It claims that the Commission, through the reciprocity provision, has reached beyond its statutory authority and is illegally attempting to regulate entities, including NPPD, over which the Commission has no jurisdiction, in violation of the Federal Power Act and the Tenth Amendment to the Constitution. NPPD admits that pursuant to Nebraska law, all state power districts are obligated to provide open access transmission service. They have been doing so for years. This is doubtless why, after Order No. 888 issued, another Nebraska public power district so easily obtained a safe harbor declaration. See Omaha Pub. Power Dist., 81 F.E.R.C. ¶ 61,054 (1997). In light of this, the Commission argues—and we agree—that NPPD's petition is unripe. Since NPPD already offers open access transmission, it is far from certain that the reciprocity

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[7] "Nebraska is unique among the States in the Union in that all generation, transmission and distribution service is provided by public entities, municipalities and cooperatives whose governing boards are responsible to, and serve at the voting pleasure of, the rate-payers they serve." NPPD Brief at 2.

provision will have any effect on it.[8] It certainly has not demonstrated any particular hardship that it would suffer if we refused to engage in pre-enforcement judicial review. See AT&T Corp. v. Iowa Utils. Bd., 525 U. S. 366, 386 (1999). From all that appears, no public utility has refused, or even threatened to refuse, to give NPPD access to its transmission system in the wake of [Page 37] Order No. 888.[9] Given the fact that public utilities may waive the reciprocity provision anyway, and that NPPD has the same option of obtaining a safe harbor as did the Omaha Public Power District, we are not persuaded that the provision is currently altering NPPD's conduct of its affairs or that withholding judicial review will cause it any hardship whatever. "Unlike the drug manufacturers in Abbott Laboratories [v. Gardner, 387 U.S. 136 (1967)], but like the cosmetics companies in Toilet Goods Ass'n v. Gardner, 387 U.S. 158, 164 (1967), NPPD need not change its "behavior or risk costly sanctions." Clean Air Implementation Project v. EPA, 150 F.3d 1200, 1205 (D.C. Cir. 1998). Furthermore, exactly how the Commission will fill in the contours of the reciprocity provision remains to be seen. That it may defer to state commissions) as it indicated in Houston Lighting & Power Co., 81 F.E.R.C. ¶ 61,015 (1997), order on reh'g, 83 F.E.R.C. ¶ 61,181 (1998), affects NPPD's contention that the Commission is seeking to bring about nationwide uniformity by forcing non-public utilities to comply with its "detailed mandates." NPPD Brief at 5. We therefore believe the issues raised would benefit from a more concrete setting in which NPPD can demonstrate exactly how the reciprocity provision has affected its primary conduct. See Clean Air

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[8] The Commission made clear that existing contracts will not be affected. See Order 888-A, ¶ 31,048 at 30,181.

[9] For this reason we find unpersuasive NPPD's claim that the Tariff's reciprocity provision places it at a disadvantage in negotiations because a public utility may simply refuse to provide service without any fear of a Commission enforcement action. See NPPD Reply Brief at 4-5.

Implementation Project, 150 F.3d at 1204. For all these reasons, NPPD's challenge to the reciprocity provision is not ripe for judicial review.

B. Limitation on Reciprocity

The Investor Owned Utilities (IOUs) challenge the following limitation on reciprocity: non-public utilities owe reciprocal open access only to the public utility from which they take open access service—not to all utilities. See IOU Brief at 40-44; IOU Reply Brief at 18-20. These petitioners argue that the Commission has left open the door for non-public utilities [Page 38] to discriminate against all other utilities and that it has done so solely because of tax considerations that no longer apply.

We agree with Commission counsel that tax considerations were not the only basis on which the Commission's limitation rested. The Commission stated that "the reciprocity requirement strikes an appropriate balance by limiting its application to circumstances in which the non-public utility seeks to take advantage of open access on a public utility's system." Order 888, ¶ 31,036 at 31,762. The Commission also explained that it "do[es] not have the authority to require non-public utilities to make their systems generally available." Id. at 31,761. The Commission stated also that it did not want broad open access reciprocity to jeopardize the tax-exempt financing non-public utilities enjoy,[10] that the IRS was then reexamining the question, id. at 31,762, and that if the tax issue is favorably resolved, it will reconsider the matter. Order 888-A, ¶ 31,048 at 30,287. The IRS has now acted. See Temporary Regulations § 1.141-7T(f), in 63 Fed. Reg. 3256 (1998). The IOUs argue that we must therefore remand for reconsideration. See IOU Brief at 44 (citing Panhandle Eastern Pipeline v. FERC, 890

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10 See 26 U.S.C. §§ 141, 142 (permitting "private activity" bonds and "local furnishing" bonds, respectively).

F.2d 435, 439 (D.C. Cir. 1989); National Fuel Gas Supply Corp. v. FERC, 899 F.2d 1244, 1249-50 (D.C. Cir. 1990); Ciba-Geigy v. EPA, 46 F.3d 1208 (D.C. Cir. 1995)).

We think not. So far as we know, the IRS has not finalized its temporary and proposed regulations. The IRS acknowledges that its temporary regulations "raised[ ] a number of complex technical issues" many of which "may need to be addressed legislatively" and it anticipates that the finalization process will take three years to accomplish. 63 Fed. Reg. at 3258-59. Second, as the Commission indicates, the possible tax consequences of requiring open access from non-jurisdictional utilities was its secondary concern. The Commission's greater concern was its lack of jurisdiction to do what the IOUs ask And lastly the Commission should be [Page 39] taken at its word that it will reconsider the scope of reciprocity when and if the temporary tax regulations are finalized.

V. STRANDED COST RECOVERY PROVISIONS

Ordering open access transmission, Order 888-A explains that "[t]he most critical transition issue that arises as a result of the Commission's actions in this rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered." Order 888-A, ¶ 31,048 at 30,346. "If a former wholesale requirements customer or a former retail customer uses the new open access to reach a new supplier," FERC said, "we believe that the utility is entitled to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime." Order 888, ¶ 31,036 at 31,789.

According to FERC, these "stranded" costs consist pre dominantly of costs of building generation capacity, which utilities incurred with the expectation that they would use the additional capacity to serve existing customers. See Notice

of Proposed Rulemaking, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. ¶ 32,507 at 32,863-64, 59 Fed. Reg. 35,274 (1994) ("Stranded Cost NOPR"). Because of the increased competition in the generation market that will result from open access, this capacity may become underutilized or uneconomical, i.e., "stranded." Stranded costs also include nonrecurring costs approved by regulators that, in order to avoid rate increases, were recovered over a period of years instead of at the time the expenditures were made. Known as "regulatory assets," these costs include deferred income taxes, deferred pension and other employee benefit and retirement costs, research and development, extraordinary property losses, and the phase-in of new plant costs. Nuclear decommissioning costs and costs to buy out high-priced fuel and power contracts may also become stranded as a result of open access.

[Page 40] Exercising its exclusive jurisdiction over wholesale power sales, FERC through Order 888 gave utilities the opportunity to recover their stranded costs from former wholesale customers who take advantage of open access transmission to purchase power from other suppliers. Order 888, ¶ 31,036 at 31,810. With respect to stranded costs resulting from state-ordered retail wheeling, Order 888 provides that FERC will consider stranded cost claims only when state regulatory agencies lack authority to do so. Id. at 31,824-25. Order 888 also designated FERC as the primary forum for stranded cost claims stemming from what are known as new municipalizations and municipal annexations. See Order 888-A, ¶ 31,048 at 30,404; Order 888-B, 81 FERC at 62,104. Stranded costs in these situations result from retail (as opposed to wholesale) power sales.

Petitioners challenge nearly every aspect of FERC's stranded cost policy as set forth in Order 888, from the mechanics of calculating customers' stranded cost obligations to whether FERC has authority to address

stranded costs at all. We begin with those challenges that relate to the recovery of wholesale stranded costs (Section V.A), then turn to challenges to Order 888's treatment of retail stranded costs (Section V.B). We affirm FERC's stranded cost policy in all respects, except we vacate that portion of the orders dealing with the treatment of energy costs in the market option and remand to FERC for further explanation. See Section V.A.5.c.

A. Wholesale Stranded Costs

In requiring nondiscriminatory open access transmission as a remedy for undue discrimination, FERC recognized that it "cannot change the rules of the game without providing a mechanism for recovery of the costs caused by such regulatory-mandated change." Order 888-A, ¶ 31,048 at 30,346. Under the pre-open access regulatory regime, utilities entered into long-term contracts to make wholesale power sales to municipal, cooperative, and investor-owned utilities. See Stranded Cost NOPR, ¶ 32,507 at 32,862. Because these customers had no source of power supply other than [Page 41] their historic utility, these contracts were typically extended at the end of their term. This produced an implicit obligation by the utilities to continue satisfying their customers' power needs, as well as a reciprocal expectation by customers of continued service. See id. at 32,863-64. To satisfy expected customer demand, utilities invested money, built facilities, and entered into long-term fuel or power contracts, relying on the "regulatory compact" under which utility shareholders accepted lower rates of return on their investment in exchange for the certainty of regulated rates and resulting ability to recover prudently incurred costs. See Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. & Regs. 32,514 at 33,049, 60 Fed. Reg. 17,662 (1995).

Order 888 fundamentally undermines utilities' expectation of continued service and cost recovery. A utility's requirements customers may now use the utility's open access transmission service to purchase power from other suppliers at the end of their contract terms. If customers leave before paying their share of costs the historic utility incurred on their behalf, the utility will be left with stranded costs, which it will either absorb or shift to remaining customers.

Unless utilities are able to recover stranded costs, FERC reasoned, their ability to compete and attract investor capital in a deregulated market may be seriously impaired. FERC therefore decided that it had to "address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced." Order 888, ¶ 31,036 at 31,635. In reaching this conclusion, FERC relied on its experience in restructuring the natural gas industry, where this court faulted it for failing to provide transitional mechanisms such as stranded cost recovery. FERC explained: "We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible." Id.

[Page 42] In shaping its stranded cost recovery mechanism, FERC had to balance two competing interests: speeding the transition to competition versus protecting utilities that had incurred costs with the expectation that their customers would remain and eventually pay those costs through electricity rates. Allowing recovery of stranded costs, FERC acknowledged, would delay full realization of the benefits of open access-lower electricity rates—because customers facing stranded cost liability might continue purchasing power from their historic utility even though competitors are selling power at lower rates. See Order 888-A, ¶ 31,048 at 30,355. Indeed, a customer would only switch

suppliers if the competitor offered a rate less than the historic utility's rate plus the customer's stranded cost liability. But given the highly regulated nature of the electricity industry, in which utilities incurred costs with the expectation of recouping them, FERC concluded that the delay was a necessary component of its open access program. See id. Mindful of its ultimate goal of converting the electricity industry into a competitive market, however, FERC fashioned the stranded cost recovery provisions to be transitional, allowing utilities to recover stranded costs only in connection with wholesale requirements contracts entered into on or before July 11, 1994 (the date of the stranded cost notice of proposed rulemaking). See 18 C.F.R. § 35.26(b)(8), 35.26(c)(1)(v)-(vi).

As to precisely who should pay for stranded costs, utilities and customers not surprisingly had dramatically different positions. Customers argued that utilities should absorb most, if not all, stranded costs. Utilities (and their investors) argued that customers should pay.

Facing an enormously difficult task in balancing these sharply conflicting positions, FERC crafted a rule that requires customers to pay stranded costs but only in certain circumstances. Most important, in order to recover stranded costs from a customer, the historic utility must prove that it had a reasonable expectation of continued service to that particular customer for a certain number of years beyond the end of the contract term; a utility unable to prove such an expectation may not recover stranded costs under Order 888. [Page 43] See 18 C.F.R. § 35.26(c)(2)(i). Moreover, a utility able to demonstrate a reasonable expectation of continued service may recover stranded costs only if its wholesale customer actually takes advantage of the utility's open access tariff to obtain access to a new generation supplier at the end of its contract term (i.e., the former customer continues to use the historic utility's transmission service but no longer purchases power from it). See 18 C.F.R. § 35,26(b)(1)(i).

Through these two limitations, FERC balanced the interests of utilities and customers by allowing utilities to recover their stranded costs only if they can demonstrate a reasonable expectation of continued service and requiring customers to pay those costs only if they take advantage of their historic utility's open access transmission to reach cheaper sources of power. And of course, no customer will have to pay stranded costs at all if it continues purchasing power from its historic utility throughout the period during which the utility has a reasonable expectation of continued service—precisely what the customer would have done in the absence of Order 888's open access requirement.

Under Order 888, stranded costs are calculated on a "revenues lost" basis. A departing customer's stranded cost obligation equals the estimated revenue it would have paid had it continued to purchase power from the historic utility minus the current market value of the power it would have purchased, calculated over the period the utility is determined to have a reasonable expectation of continued service to that customer. See 18 C.F.R. § 35.26(c)(2)(iii). In other words, the stranded cost formula is not tied to particular stranded assets or contractual commitments, but rather awards utilities the difference between the pre-open access cost-based rate and the post-open access market rate. Once a customer's stranded cost liability is calculated, it may pay through a lump-sum payment, installment payments, or a surcharge to the transmission rate charged by the historic utility. See Order 888, ¶ 31,036 at 31,799.

Before turning to petitioners' arguments, we emphasize what should be obvious from the foregoing summary of Order 888: Order 888 awards stranded costs to no one. It does [Page 44] nothing more than establish a mechanism by which utilities may seek to recover stranded costs. To recover stranded costs, a utility must demonstrate its continued expectation of service at an evidentiary hearing. The customer may appear at that hearing and, through

evidentiary submissions of its own, attempt to demonstrate that the utility had no such expectation. Only after such a hearing may FERC decide whether a utility can recover stranded costs and, if so, how much.

Petitioners mount many challenges to Order 888's stranded cost recovery provisions. For purposes of analysis, we group these challenges into five categories: (1) challenges to FERC's authority to provide for stranded cost recovery (section V.A.1); (2) claims that Order 888 conflicts with cost causation principles and case law developed under the Natural Gas Act (section V.A.2); (3) challenges to FERC's Mobile-Sierra findings (section V.A.3); (4) claims that FERC arbitrarily and capriciously failed to provide for stranded cost recovery by certain entities, such as transmission dependent utilities and generation and transmission cooperatives (section V.A.4); and (5) challenges to various technical aspects of Order 888's stranded cost recovery provisions (section V.A.5).

1. FERC's Authority to Provide for Stranded Cost Recovery

A group called Petitioners Opposing Stranded Cost Recovery ("POSCR") advances three challenges to FERC's authority to provide for stranded cost recovery: (1) as a factual matter, utilities could never have had a reasonable expectation of continued service to wholesale customers beyond the contract term; (2) sections 206 and 212 of the Federal Power Act ("FPA") forbid stranded cost recovery; and (3) our decision in Cajun Elec. Power Coop., Inc. v. FERC, 28 F.3d 173 (D.C. Cir. 1994), holds that stranded cost recovery is anticompetitive. We consider each argument in turn.

a. Reasonable expectation of continued service

To recover stranded costs relating to a specific departing wholesale requirements customer, a utility must show that it [Page 45]had a reasonable expectation of service to that

customer beyond the term of its existing contract. See 18 C.F.R. § 35.26(c)(2)(i). Pointing out that contracts define the extent of the parties' obligations and that customers have long exercised their rights to purchase power from other suppliers at the end of their contract terms. POSCR contends that utilities could never have had an expectation of service beyond their contract terms. In considering this argument it is important to remember that Order 888 does not itself award stranded costs; it merely establishes a procedure by which utilities may petition FERC in individual proceedings to recover stranded costs from a specific customer based on a specific evidentiary showing. Utilities failing to show an expectation of continued service will be unable to recover stranded costs. POSCRs challenge thus amounts to a claim that no utility could ever, under any circumstances, have had a reasonable expectation to serve a wholesale customer beyond the term of its contract. We review this claim under the APA's familiar arbitrary and capricious standard. See 5 U.S.C. § 706(2)(A); Williams Field Services Group, Inc. v. FERC, 194 F.3d 110, 115 (D.C. Cir. 1999).

Responding to this same challenge in Order 888-A, FERC explained that utilities historically had an implicit obligation to serve customers beyond the contract term for a simple reason: Customers had no means of reaching alternative suppliers. See Order 888-A, ¶ 31,048 at 30,354. As part of that obligation to serve, FERC found, a local utility "had a concomitant obligation to plan to supply [its] customers' continuing needs, and planned its system taking account of the wholesale load. In many cases the wholesale customers participated by supplying load forecasts." Id. In making capital decisions and predicting future demand, utilities frequently consulted with their wholesale requirements customers. For these reasons, FERC concluded, utilities may have a reasonable expectation of continued service to particular customers. See id. at 30,354-55.

Not only is FERC's judgment about utilities' reasonable expectations precisely the type of policy assessment to which we owe great deference, but POSCR points to nothing sug-[Page 46]gesting that FERC's reasoning is arbitrary and capricious. In fact, POSCRs argument completely ignores the highly regulated nature of the electricity industry prior to Order 888. Unlike competitive markets, where buyers may freely purchase from many sellers, the monopolistic character of the electricity industry, combined with the congressionally imposed regulatory structure, left requirements customers highly dependent on a single supplier—their historic utility. Indeed, as interveners point out, utilities were even unable to choose not to renew an expiring wholesale requirements contract without first notifying FERC. See 18 C.F.R. § 35.15 (1995) (repealed by Order 888). Although it may well be true, as POSCR argues, that some wholesale customers have long been able to purchase unbundled transmission service, we think such evidence is best reserved for individual proceedings, where a department customer can attempt to refute the utility's claim that it had an expectation of continued service.

b. Sections 206 and 212 of the FPA

Section 206(a) of the FPA gives FERC authority to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force" if it finds that any existing arrangement "is unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a). Relying on section 206(a) as the basis for Order 888, FERC found that utilities had used their monopoly transmission power to discriminate against potential competitors and that such practices would increase as competitive pressures in the industry increased. Order 888, ¶ 31,036 at 31,676, 31,682.

POSCR contends that Order 888's stranded cost recovery provisions themselves violate FERC's own construction of section 206, the construction FERC relied on

as the basis for the open access rule. According to POSCR, "[t]he stranded cost rule perpetuates the very 'discrimination' FERC found unlawful, and subjects the same victims—customers held hostage to uneconomic electric generation by transmission monopolists—to continued abuse."

[Page 47]In challenging FERC's policy decision to provide for stranded cost recovery, POSCR conflates the violation (FERC's generic determination that utilities' practice of prohibiting access to their transmission lines on reasonable terms was unduly discriminatory) with the remedy (FERC's more limited finding that recovery of stranded costs in particular circumstances would not be unduly discriminatory). FERC has not, as POSCR contends, given "unduly discriminatory" different meanings; rather, it has applied the term in different contexts.

POSCR's argument thus boils down to a challenge to FERC's conclusion that the stranded cost recovery prescribed in Order 888 is not unduly discriminatory, a challenge meriting arbitrary and capricious review. Viewed through this lens, we think FERC more than adequately explained why it concluded that stranded cost recovery is not unduly discriminatory—stranded cost recovery, FERC said, is transitional only, follows cost causation principles, and requires utilities to prove that they had a reasonable expectation of continued service. FERC faced an enormously difficult task. It had to balance the transition to competitive markets against the need to maintain the competitiveness of utilities that had incurred costs based on a reasonable expectation that they would recoup them. We find nothing either arbitrary or capricious in how FERC struck this balance.

POSCR next contends that stranded cost recovery violates section 212 of the FPA, which governs the rates for transmission ordered by FERC pursuant to section 211. 16 U.S.C. §§ 824j-k. Because FERC-jurisdictional utilities are no longer subject to sections 211 and 212, this argument

relates only to those situations in which FERC orders nonjurisdictional transmitting utilities to wheel under section 211 and these utilities then seek to recover stranded costs in their transmission rates. See 18 C.F.R. § 35.26(c)(1)(vi)-(vii). Section 212 allows FERC to order "rates, charges, terms, and conditions which permit the recovery by [a transmitting] utility of all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate, verifiable and [Page 48] economic costs, including taking into account any benefits to the transmission system of providing the transmission service, and the costs of any enlargement of transmission facilities." 16 U.S.C. § 824k(a). Contending that economic costs" cannot be read to include payment of stranded costs, which by definition relate to generation (not transmission) services, POSCR reads section 212 to preclude stranded cost recovery.

Straightforward application of the Chevron doctrine demonstrates the lack of merit in this argument. See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984). Because Congress has not "directly spoken to the precise question at issue"—do "economic costs" include stranded costs?—and because nothing in the statute precludes recovering through transmission rates costs that were traditionally recovered through generation rates, the term "economic costs" is ambiguous. Id. at 842.

Proceeding to Chevron's second step, we ask whether FERC has reasonably interpreted the term "economic costs." See id. at 843. We have no doubt that it has. As FERC explained, but for section 211 wheeling orders, there would be no stranded costs. Stranded costs, according to FERC, are therefore economic costs of section 211 wheeling. See Order 888-A, ¶ 31,048 at 30,390. POSCR offers nothing to undermine this eminently reasonable interpretation of the statute.

c. Implications of Cajun

Next, POSCR contends that our decision in Cajun Elec. Power Coop., Inc. v. FERC, 28 F.3d 173 (D.C. Cir. 1994), condemns stranded cost recovery as anticompetitive. A pre-Order 888 decision, Cajun reviewed two tariffs allowing a utility, Entergy Corporation, to sell power at market rates, and a third tariff providing for open access to Entergy's transmission services at cost-based rates. The third tariff gave Entergy an opportunity to recover stranded costs from customers who no longer purchase power from Entergy but use its transmission lines to reach other suppliers—exactly the circumstances in which Order 888 provides for stranded cost recovery. Under the tariff, the stranded cost charge was included in Entergy's transmission rate. See id. at 175-77.

[Page 49] Characterizing the stranded cost provision as a "tying arrangement" under antitrust law, Cajun explained that under the tariff, Entergy could charge a former customer for the cost of generation services when the customer wished to purchase only transmission services; because Entergy has a monopoly over transmission, customers would have no choice but to pay costs relating to generation they no longer wanted from Entergy. Id. at 177-78. Thus, because "Entergy could use its monopoly over transmission services to eliminate competition in the market for generation services," the net effect of the tariffs may be anticompetitive. Id. at 176.

Of significance to this case, however, we did not strike down the tariffs. Instead, we remanded the case for FERC to determine "how much competition in fact is dampened" by the stranded cost provision. Id. at 178. Thus, contrary to POSCR's suggestion, Cajun does not represent a blanket condemnation of stranded cost recovery; rather, recognizing that such recovery could be anticompetitive, Cajun directed FERC to evaluate and justify the potential anticompetitive impact. This is precisely what FERC has done in Order 888. It expressly considered the anticompetitive effects of stranded cost recovery. See Order 888-A, ¶ 31,048 at

30,372-74. Then, stressing the transitional nature of the recovery and the fact that recovery was compelled by the open access requirement, which utilities could not have anticipated, FERC concluded that the limited anticompetitive effects of stranded cost recovery were both a necessary and acceptable consequence of the transition to competition. See id. Not only has POSCR offered no evidence that would lead us to question FERC's conclusion, but such judgments about anticompetitive effects are "the kind of reasonable agency prediction about the future impact of its own regulatory policies to which we ordinarily defer." Louisiana Energy and Power Auth. v. FERC, 141 F.3d 364, 370 (D.C. Cir. 1999).

2. Natural Gas Precedent and Conformance to Cost Causation Principles

Having rejected POSCR's arguments that FERC lacks authority to authorize stranded cost recovery, we turn to its [Page 50]argument that FERC has failed adequately to explain why Order 888 requires departing customers to pay one-hundred percent of stranded costs. In support of this argument, POSCR claims that our decisions reviewing FERC's restructuring of the natural gas industry require cost sharing; it also argues that Order 888's stranded cost recovery conflicts with the cost causation principles that traditionally govern allocation of costs.

a. Natural gas precedent: AGD, K N Energy, and UDC

In introducing competition into the electricity industry, FERC has taken essentially the same path that it took in restructuring the natural gas industry, although what FERC has done in a single order in the electricity industry (Order 888) it did in a series of orders in the natural gas industry. Because POSCR relies so heavily on FERC's natural gas orders and our decisions reviewing them, we begin by summarizing them in some detail.

Finding practices in the natural gas industry "unduly discriminatory" in violation of the Natural Gas Act, FERC

began by issuing Order 436, which "unbundled" pipeline transportation and merchant functions. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, FERC Stats. & Regs, ¶ 30,665, 50 Fed. Reg. 42,408 (1985) (rehearing orders omitted). At the time of Order 436, pipelines were facing enormous liabilities under long-term "take-or-pay" contracts. Entered into when gas prices were expected to rise, these contracts obligated pipelines to purchase minimum quantities of gas from wellhead producers at fixed prices that turned out to be well in excess of market prices. See Associated Gas Distributors v. FERC, 824 F.2d 981, 1021 (D.C. Cir. 1987) ("AGD"). Although FERC estimated take-or-pay liabilities at billions of dollars, and although Order 436 would exacerbate the take-or-pay problem by providing incentives to pipeline customers to purchase gas from cheaper suppliers, FERC declined to take any action with respect to the contracts. In AGD, we found that FERC's decision to do nothing failed to meet the requirements of reasoned decisionmaking, citing FERC's "seeming [Page 51] blindness to the possible impact of Order No. 436 on take-or-pay liability" and permanent market distortions that may result from FERC's inaction. Id. at 1021-23, 1025. Specifically, we noted, in words echoed by FERC years later in Order 888, that consumers who purchased from the "least nimble" local distribution companies would "be stuck with the burden of the overpriced gas." Id. at 1023.

In response to AGD, FERC issued Order 500, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500, FERC Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (rehearing orders omitted). Recognizing that no one segment of the gas industry was wholly responsible for the take-or-pay problem, Order 500 allowed pipelines to recover take-or-pay costs through "equitable sharing." Pipelines that willingly absorbed twenty-five to fifty percent of their costs could require sales customers to match that amount through a fixed charge.

Pipelines could recover any balance through commodity rates or volumetric surcharges, borne by both sales and transportation customers. For an overview of these components of Order 500, see KN Energy, Inc. v. FERC, 968 F.2d 1295, 1297-98 (D.C. Cir. 1992). We sustained this approach in KN Energy, holding that even though Order 500 replaced traditional "cost causation" principles with cost spreading and value-of-service concepts, it did not violate Natural Gas Act section 4's requirement that rates be just and reasonable. Id. at 1301-02. Citing statements in AGD that "all actors in the natural gas industry" are "candidates" for absorbing take-or-pay liability, we relied on "the unusual circumstances surrounding the take-or-pay problem, and the limited nature—both in time and scope—of the Commission's departure from the cost-causation principle." Id. at 1301.

Concluding that Order 436 had been only partially successful in introducing competition into the natural gas industry, FERC issued its third major restructuring order, Order 636. Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, FERC Stats. & Regs. ¶ 30,939, 57 Fed. [Page 52] Reg. 13,267 (1992) (rehearing orders omitted). That order imposed mandatory unbundling of sales and transportation services and allowed sales customers to reduce the amount of gas they had to purchase pursuant to existing contracts. When customers took advantage of this option and purchased gas from sources other than the pipelines, the pipelines were once again left with substantial take-or-pay liabilities. Labeling the costs of reducing these liabilities gas supply realignment or GSR costs, Order 636 authorized pipelines to bill current transportation customers for one hundred percent of their GSR costs by charging either a negotiated exit fee or reservation fee surcharge. Order 636 also authorized pipelines to recover all stranded costs in rate filings. In the

natural gas industry, stranded costs represented the costs of pipeline assets (such as storage facilities) used to provide bundled sales services that were not directly assignable to transportation customers. For an overview of these components of Order 636, see United Distribution Cos. v. FERC, 88 F.3d 1105, 1125-27, 1176-78 (D.C. Cir. 1996) ("UDC").

In UDC, we affirmed FERC's determination that pipelines could recover all stranded costs through filed rates, so long as FERC "adequately balanced the interests of investors and ratepayers." Id. at 1180. Reaffirming the appropriateness of the cost spreading and value-of-service principles approved in K N Energy, we found that FERC's allocation of GSR costs to pipeline transportation customers, as opposed to the pipelines themselves, properly applied those principles. Id. at 1182. Although recognizing that GSR costs stemmed from pipeline sales customers, not transportation customers, we found that FERC appropriately imposed the costs on transportation customers because these customers benefited from the availability of lower-priced transportation and also because FERC could not spread costs to the pre-Order 636 sales customers since those customers no longer purchased gas from the pipelines. Id. at 1185-86. We remanded for FERC to explain more fully why pipelines should not have to pay some of the costs, noting an inconsistency in the Commission's analysis: While FERC applied cost spreading principles to justify imposing costs on transportation customers, it [Page 53]invoked cost causation principles in concluding that pipelines should not have to pay any of these costs. Id. at 1188-90. We explicitly stated, however, that we were not saying that "it is impossible, or even improbable, that the Commission on remand can establish a convincing rationale for exempting the pipelines." Id. at 1189.

POSCR reads this history to require FERC to order cost sharing, but it ignores Order 888's explanation of the

difference between natural gas restructuring and the situation in the electricity industry. Most fundamentally, Order 888 explains, stranded cost recovery in the electricity industry conforms to cost causation principles, which normally govern the allocation of costs and require customers to pay the costs they caused. See Order 888, ¶ 31,036 at 31,798. Cost causation principles could not be applied in natural gas restructuring, Order 888 explains, because many customers had already begun purchasing gas from other suppliers before FERC bad addressed the take-or-pay problem on remand from AGD, and because the filed rate doctrine prohibits assessing charges against former customers. Id. at 31,800-01. Order 888 also explains that unlike stranded costs in the electricity industry, the take-or-pay liabilities in the gas industry were extraordinary. The billions of dollars of take-or-pay liabilities resulted not from Order 636, but from earlier regulatory policies that had encouraged pipelines to enter into long-term, fixed-price gas purchase contracts, combined with declining gas prices that made those contracts uneconomical. See Order 888-A, ¶ 31,048 at 30,380. Under all of these circumstances, "[t]o have allocated these costs solely to any one segment of the industry would have imposed a crushing new burden on that segment." Id. at 30,380-81.

Stranded costs in the electricity industry, Order 888 explains, are quite different. Resulting directly from Order 888, they represent "ordinary costs that have always been, and are currently, included in the utility's rates for electric generation approved by the Commission." Id. at 30,382. Moreover, wholesale customers may avoid stranded cost liability by continuing to purchase power from their historic utility, precisely what they probably would have done in the [Page 54] absence of Order 888. In other words, in contrast to the natural gas industry, where customers would have faced enormous new burdens had FERC forced them to pay take-or-pay costs, customers in the electricity industry face no new burdens; instead, Order 888 requires them to pay

nothing more than costs they would have had to pay in the absence of Order 888. In the electricity industry, the only effect of stranded cost recovery is delayed realization of the full benefits of a competitive market.

In light of these differences between the natural gas and electricity industries and FERC's exhaustive treatment of the natural gas restructuring in Order 888, POSCR's contention that FERC has failed "to offer a coherent rationale, rising to the level of reasoned decisionmaking" for not imposing cost sharing is wholly without merit. Equally without merit is POSCR's assertion that UDC "teaches that, were customers and utilities benefit from an open access rule/order that leads to early contract termination and where anticompetitive conduct by utilities has given rise to the need for the open access order, utilities must share transition costs." POSCR ignores three important points. First, FERC, not this court, determined that cost sharing was appropriate with respect to take-or-pay liabilities. UDC merely affirmed FERC's decision. Second, KN Energy recognized that cost sharing in the natural gas industry was a departure from the cost causation principles that normally apply, a departure justified by extraordinary circumstances in the natural gas industry. KN Energy, 968 F.2d at 1301-02. And finally, as to stranded costs that more closely resemble those at issue in this case—for example, pipeline assets that would no longer be fully employed when customers took advantage of unbundling to purchase gas from alternative suppliers—FERC ordered and UDC affirmed, that pipelines recover one-hundred percent of those costs.

b. Conformance to cost causation principles

Having established that the natural gas cases impose no obligation on FERC to order cost sharing, we next consider POSCR's argument, that the inclusion of stranded costs in [Page 55] transmission rates does not conform to cost causation principles. This is so, POSCR asserts, because Order 888's stranded cost provisions require customers to

pay through transmission rates for costs the utility previously incurred to provide generation services.

As an initial matter, we note that payment through transmission rates is only one of three ways that a departing customer may pay its stranded cost obligation; the customer also has the option of making a lump-sum payment or installment payments. Thus POSCR's challenge seems aimed only at the method of payment, not at the fact that payment is required. But even viewing POSCR's challenge more broadly, as a claim that stranded cost recovery no matter what the method of payment violates cost causation principles, we think it lacks merit.

We have explained the cost causation principle as follows: "Simply put, it has been traditionally required that all approved rates reflect to some degree the costs actually caused by the customer who must pay them." KN Energy, 968 F.2d at 1300. Given this definition, we are puzzled by POSCR's claim that because inclusion of stranded costs in transmission rates requires customers to pay currently for costs incurred in the past, it violates cost causation principles. To some degree, all utility rates reflect past costs; utilities typically expend funds today (for example, constructing generation facilities), fully expecting to recover those costs through future rates. In fact, current rates often include past costs that utilities deferred in order to avoid rate increases. Cost causation requires not that costs be incurred at the same time they are included in rates, but that the rates "reflect to some degree the costs actually caused by the customer who must pay them." Id.

In fashioning Order 888's stranded cost recovery provisions, FERC went to great lengths to ensure that customers would be responsible for only those costs they caused.

> [T]he Rule is consistent with the traditional cost causation principle because it recognizes the link

> between the incurrence of the stranded costs and the decision of a [Page 56]particular generation customer to use open-access transmission on the utility's system to leave the utility's generation system and shop for power, and bases the utility's ability to recover stranded costs on its ability to demonstrate that it incurred costs with the reasonable expectation that the customer would remain on its generation system beyond the term of the contract.

Order 888-A, ¶ 31,048 at 30,382.

We cannot see how including stranded costs in transmission rates instead of lump sum payments changes this analysis. To the extent POSCR is arguing that including in a transmission rate costs incurred to provide generation services violates cost causation principles, we reiterate that stranded costs are not costs of providing the physical transmission services but, as Order 888-A explains, they are utilities' cost of open access transmission. See Order 888-A, ¶ 31,048 at 30,389 & n.634. More generally, given the fundamental changes wrought by Order 888 and the unprecedented opportunity for customers to purchase power from alternative suppliers, we are quite comfortable deferring to FERC's judgment that stranded cost recovery—through transmission rates or otherwise—conforms to cost causation principles. In fact, FERC may have violated cost causation principles had it failed to assign stranded costs to customers who caused them.

POSCR next argues that Order 888 is unduly discriminatory because including stranded costs in transmission rates forces transmission customers who previously used a utility's generation capacity to pay higher costs than new transmission customers. Disagreeing, FERC determined that requiring customers receiving similar services to pay different rates is necessitated by Order 888's open access requirement. See Order 888-A, ¶ 31,048 at

30,388-90. Cf. AGD, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). Moreover, FERC concluded the application of cost causation principles justifies this different treatment. See Order 888-A, ¶ 31,048 at 30,379, 30,388-90. Seeing noth-[Page 57]ing unreasonable (let alone arbitrary or capricious) in FERC's policy judgment, we reject POSCR's challenge.

Nor do we agree with POSCR's argument that stranded cost recovery violates the filed rate doctrine, which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." Western Resources, Inc. v. FERC, 72 F.3d 147, 149 (D.C. Cir. 1995). In Western Resources, we held that FERC's assignment to current customers of costs relating to take-or-pay liabilities did not violate the filed rate doctrine. Recognizing that "a central purpose of the doctrine is to enable purchasers to know in advance the consequences of the purchasing decisions they make," we determined that the doctrine was satisfied where customers received "adequate notice of a rate in advance of the service to which it relates." Id. at 149-50 (internal quotation marks omitted). Order 888's stranded cost policy satisfies this requirement because customers electing to purchase power generation from a source other than the transmitting utility from which they had purchased power in the past will be aware of the costs when making that decision.

3. FERC's Mobile-Sierra Findings

Under the Supreme Court's Mobile-Sierra doctrine, where parties have negotiated a contract that sets firm prices or dictates a specific method of computing charges and includes a clause denying either party the right to change such prices or charges unilaterally, "FERC may abrogate or modify the contract only if the public interest so requires." Texaco, Inc. v. FERC, 148 F.3d 1091, 1095 (D.C. Cir. 1998); see also FPC v. Sierra Pacific Power Co., 350 U.S. 348, 353-

55 (1956); United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332, 344-45 (1956). We have recognized that "the 'public interest' that permits FERC to modify private contracts is different from and more exacting than the 'public interest' that FERC seeks to serve when it promulgates its rules." Texaco, 148 F.3d at 1097.

FERC usually makes Mobile-Sierra determinations on a case-by-case basis. A party seeking to modify a contract [Page 58]containing a Mobile-Sierra clause petitions FERC. That party bears the burden of convincing FERC that the modification is in the public interest.

Order 888 departs from this normal case-by-case practice by making two generic public interest findings, one focused on utilities, the other on customers. These generic findings relieve utilities and customers of the burden of demonstrating in individual proceedings that the proposed modifications are in the public interest. As to utilities, Order 888 ruled that it was in the public interest to allow them to add stranded cost amendments to their contracts if they could demonstrate, in accordance with Order 888, that they had a reasonable expectation of continued service. See Order 888-A, ¶ 31,048 at 30,394-95. This finding rested on two considerations: that the burden of unrecoverable stranded costs could impair utilities' access to capital markets, which could in turn precipitate the departure of other customers, thus worsening the utilities' financial condition and threatening its ability to provide reliable service; and that allowing customers to leave a utility without paying their share of costs would shift those costs to other customers who lack alternative power sources. See Order 888, ¶ 31,036 at 31,811. For its second generic finding, FERC concluded that it was in the public interest to allow customers to modify their wholesale requirements contracts in any way upon a showing that the terms are no longer just and reasonable. See Order 888-A, ¶ 31,048 at 30,189. Observing that the contracts in question "were entered into during an era in

which transmission providers exercised monopoly control over access to their transmission facilities," FERC based this finding on the unequal bargaining power between utilities and customers. Id. at 30,193. Because "[m]any of these contracts were the result of uneven bargaining power between customers and monopolist transmission providers," FERC reasoned, "the unprecedented competitive changes that have occurred (and are continuing to occur) in the industry may render their contracts to be no longer in the public interest or just and reasonable." Id.

Challenging the first finding, POSCR argues that FERC lacks authority to make a generic public interest finding that [Page 59]allows for contract modification in an entire class of cases. POSCR insists that FERC can only proceed on a case-by-case basis, determining in each case whether a particular contract modification is in the public interest. Even if FERC has authority to make generic findings, POSCR goes on to argue, FERC's Order 888 finding is unsupported by substantial evidence. The investor owned utilities ("IOUs") challenge the second finding, arguing that allowing customers to seek modification of all contract terms, while limiting utilities to stranded cost provisions, fails adequately to balance competing interests.

a. FERC's authority to make a generic public interest finding

POSCR correctly observes that FERC has pointed to no case in which a court affirmed a generic Mobile-Sierra finding. At the same time, POSCR has cited no case prohibiting FERC from making a generic finding, nor have we found one. In the absence of definitive authority in either direction, and given the unique circumstances of this case and our traditional deference to FERC's expertise, we find no fault with FERC's generic determination.

The Mobile-Sierra doctrine "represents the Supreme Court's attempt to strike a balance between private

contractual rights and the regulatory power to modify contracts when necessary to protect the public interest." Northeast Utilities Serv. Co. v. FERC, 55 F.3d 686, 689 (1st Cir. 1995). In Mobile, the Supreme Court recognized that intervening circumstances may create a situation in which contractual terms and conditions that were just and reasonable at the time the contract was executed are no longer just and reasonable. 350 U.S. at 344-45. But concluding that a utility is not typically "entitled to be relieved of its improvident bargain," the Sierra Court required that FERC's predecessor, the Federal Power Commission, show more than that the contract was unjust and unreasonable—the Commission had to find that contract modification was in the public interest. 350 U.S. at 355.

In most cases, intervening circumstances are unique to the relationship between contracting parties. See, e.g., Northeast [Page 60] Utilities, 55 F.3d 686 (affirming FERC's modification to the rate schedule of a contract as a condition for approval of a merger between two parties to the contract). But where intervening circumstances—in this instance, FERC—mandated open access transmission—affect an entire class of contracts in an identical manner, we find nothing in the Mobile-Sierra doctrine to prohibit FERC from responding with a public interest finding applicable to all contracts of that class. Moreover, in providing for stranded cost recovery, FERC has not relieved utilities of "improvident bargains," the concern of the Sierra Court; rather, it has recognized that open access affects all utilities in the same manner, namely leaving them vulnerable to potentially unrecoverable stranded costs. In fact, to deny FERC authority to make generic findings in such a case would simply impose on it and the parties the repetitive burden of proving the public interest in each and every case.

In sustaining FERC's generic finding, we are influenced by the fact that before recovering stranded costs, a utility must prove that it had a reasonable expectation of continued

service to a particular customer. As the IOUs intervening on behalf of FERC explain, the need to make this showing adds a particularized element to FERC's generic public interest finding. Viewed this way, Order 888's generic finding is more precisely stated as follows: It is in the public interest to allow utilities to recover stranded costs if they can prove that they had a reasonable expectation of continued service to particular customers. If a utility can demonstrate that it had a reasonable expectation of continued service to a particular customer, and incurred costs based on that expectation, then it would be against the public interest to require other customers or shareholders to bear those costs. As Order 888 explains, "the case-by-case findings that some commenters seek will, in effect, be made when the Commission determines whether to approve a proposed stranded cost amendment to a particular contract." Order 888, ¶ 31,036 at 31,813.

We stress that generic Mobile-Sierra findings are appropriate only in rare circumstances. Order 888 is just such a circumstance. It fundamentally changes the regulatory envi-[Page 61]ronment in which utilities operate, introducing meaningful competition into an industry that since its inception has been highly regulated and affecting all utilities in a similar way.

b. FERC's stranded cost public interest finding

Having concluded that the Mobile-Sierra doctrine permits a generic finding in this case, we turn to POSCR's claim that the finding was unsupported by substantial evidence. POSCR faults FERC for failing to adduce evidence to support its conclusion that denying stranded cost recovery would put particular utilities in financial peril. POSCR also thinks that the impact on customers of failing to provide for stranded cost recovery is insufficient to support a public interest finding.

With respect to POSCR's first point, it is certainly true that Sierra identified impairment of "the financial ability of the public utility to continue its service" as one factor supporting a public interest finding. Sierra, 350 U. S. at 355. Relying on this, POSCR challenges FERC's public interest finding on the ground that the record contains no individual assessments of the financial condition of public utilities.

Although public interest findings made on a case-by-case basis necessarily evaluate the harm to the particular utility seeking modification, that is not true where, as here, FERC implements a generic change in the industry. Just as that change can support a generic public interest finding, that generic finding can be supported by generic industry-wide evidence. FERC has produced such evidence. The record contains estimates of stranded costs amounting to $200 billion or more. See Stranded Cost NOPR, ¶ 32,507 at 32,866. It also includes comments from representatives of the financial community stating that "the prospect of not recovering stranded costs could erode a utility's ability to attract capital."

POSCR points out that eighty-five to ninety percent of the estimated $200 billion of stranded costs relates to retail sales, not wholesale sales. True enough, but we find no basis for questioning FERC's conclusion that unrecovered stranded [Page 62] costs of even ten percent of 200 billion—the low end of the wholesale stranded cost estimate—could have serious consequences for utilities. See Order 888, ¶ 31,036 at 31,790. In any event, if POSCR turns out to be correct about the absence of a wholesale stranded cost problem, few utilities will avail themselves of Order 888's stranded cost recovery provisions.

POSCRs second argument focuses on FERC's finding that "if some customers are permitted to leave their suppliers without paying for stranded costs, this may cause an excessive burden on the remaining customers who, for whatever reason, cannot leave and therefore may have to bear

those costs." Order 888, ¶ 31,036 at 31,811. POSCR does not agree with FERC that the failure to recover stranded costs will create an "'undue burden" on remaining customers. But disagreeing with FERC is not enough. To prevail in this court, POSCR must demonstrate that FERC's prediction that failure to recover stranded costs will create an undue burden on remaining customers is unsupported by substantial evidence, see 16 U.S.C. § 8251(b), which is another way of saying it is arbitrary and capricious. See Michigan Consolidated Gas Co. v. FERC, 883 F.2d 117, 124 (D.C. Cir. 1989) ("[M]aking ... predictions is clearly within the Commission's expertise and will be upheld if rationally based on record evidence.") (internal quotation marks omitted). This POSCR has failed to do.

c. FERC's public interest finding regarding customers

The IOUs mount two challenges to FERC's second public interest finding—that it was in the public interest to allow customers to seek modification of their wholesale requirements contracts. Unlike POSCR, the IOUs make no claim that the finding lacks substantial evidence; rather, they contend that FERC's decision to allow customers to seek modification of all contract terms, while limiting utilities to adding stranded cost provisions, fails to balance FERC's competing concerns: respecting existing contractual commitments and accelerating the transition to competition. They also complain that FERC has failed adequately to explain [Page 63] why affording customers this broad ability to modify their contracts is in the public interest.

FERC gave two justifications for affording customers a broader opportunity than utilities to modify their contracts, both of which seem perfectly rational to us. First, Order 888-A explains, "these contracts were entered into during an era in which transmission providers exercised monopoly control over access to their transmission facilities." Order 888-A, ¶ 31,048 at 30,193. Also, the "unprecedented competitive changes ... may affect whether such contracts continue to be

just and reasonable or not unduly discriminatory both as to the direct customers of the contracts, as well as to indirect, third-party consumers...." Id. at 30,193-94. In fact, Order 888 rests on the very premise that by denying competitors access to their transmission lines, utilities engaged in undue discrimination. Confined to purchasing power from their local utilities, customers suffered from this lack of access. In the natural gas restructuring, we affirmed FERC's decision to allow customers to seek to modify their sales contracts because those contracts "necessarily reflect the pipelines' monopoly power." AGD, 824 F.2d at 1017. The same reasons call for affirming FERC's decision here. In addition, as FERC has explained, the harm to third parties (i.e., customers of the wholesale requirements customers) that may result from adherence to uneconomical contracts further justifies its conclusion. See Order 888-A, ¶ 31,048 at 30,194. Remedying potential unfairness to utilities by allowing them to seek stranded cost recovery if a customer shortens the term of a contract, FERC struck a balance between customers and utilities that can hardly be characterized as arbitrary or capricious.

4. Availability of Stranded Cost Recovery to Nonjurisdictional Utilities and G&T Cooperatives

Section 201 of the FPA gives FERC jurisdiction over "public utilities" but not over federal and state utilities. 16 U.S.C. § 824. Although FERC required utilities not subject to its jurisdiction ("nonjurisdictional utilities") to provide reciprocal open access transmission when they use a jurisdic-[Page 64]tional utility's open access tariff, it declined to provide a mechanism for them to recover stranded costs, Explaining that it promulgated its reciprocity provision pursuant to fairness concerns, not statutory authority, FERC reasoned that it lacked jurisdiction to provide stranded cost recovery for nonjurisdictional utilities. See Order 888-A, ¶ 31,048 at 30,364. FERC recommended that these utilities include stranded cost provisions in their open access tariffs;

those tariffs would be reviewed not by FERC but by the appropriate regulatory authority. See id.

Dairyland petitioners contend that FERC acted arbitrarily and capriciously in denying nonjurisdictional utilities stranded cost recovery, arguing that the same "fairness" concerns invoked by FERC to require reciprocal open access transmission require the award of stranded costs. To be sure, FERC may have had authority to include stranded cost recovery as a provision of Dairyland's open access tariff. But Dairyland has offered no reason for thinking that FERC's refusal to do so was arbitrary and capricious. Given the limited scope of FERC's stranded cost provisions, its lack of jurisdiction over entities like Dairyland, and the ability of nonjurisdictional utilities to include stranded cost provisions in their open access tariffs, we see no reason to question FERC's judgment on this issue.

The same is true with respect to the transmission dependent utilities ("TDUs"). Like the Dairyland petitioners, they claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for them to recover stranded costs. Owning few or no transmission facilities, TDUs serve their loads using other utilities' transmission systems. Not only are TDUs nonjurisdictional utilities, but, as Order 888-A explains, open access does not cause their costs to become stranded—their customers have always had an option to use other utilities' transmission services to purchase power. See Order 888-A, ¶ 31,048 at 30,365.

Dairyland also contends that FERC acted arbitrarily and capriciously when it declined to treat a generation and transmission ("G&T") cooperative and its member distribution [Page 65] cooperatives as a single economic unit for stranded cost purposes. G&T cooperatives provide bundled wholesale power to their member distribution cooperatives, who in turn sell the power to the members' retail customers. Observing that cooperatives, unlike traditional utilities, are not vertically integrated but instead

function as single economic units, Dairyland claims that G&T cooperatives have reasonable expectations of continued service to retail customers of their member cooperatives that differ substantially from the expectations public utilities have with respect to retail customers of their wholesale customers. This difference, Dairyland argues, requires FERC to allow G&T cooperatives to recover stranded costs from their member cooperatives' customers.

Rejecting Dairyland's petition for rehearing on this point, FERC noted that treating a G&T cooperative and its members as a single economic unit for purposes of stranded cost recovery would conflict with its treatment of these same cooperatives as distinct entities in its reciprocity provisions. Order 888-A, ¶ 31,048 at 30,366. There, FERC agreed with Dairyland's proposal that if a G&T cooperative seeks open access transmission from a public utility, "then only the G&T cooperative, and not its member distribution cooperatives, would be required to offer [reciprocal] transmission service." Order 888, ¶ 31,036 at 31,763. Moreover, FERC reasoned, recovering from a retail customer of a member cooperative is, in effect, recovering from an indirect customer, a situation that FERC declined to include in its stranded cost rule. See Order 888-A, ¶ 31,048 at 30,166.

It is true that FERC could have treated G&T cooperatives and their members as single economic units for stranded cost purposes. But FERC's explanation of why it chose not to do so, particularly the fact that G&T cooperatives and their members were treated is distinct entities for reciprocity purposes, is entirely reasonable.

5. Challenges to Technical Aspects of Order 888's Stranded Cost Recovery Provisions

Several petitioners mount challenges to various technical aspects of the stranded cost recovery provisions. Before [Page 66] addressing these challenges, we emphasize the very limited scope of our review. For us to undo what FERC

has done, petitioners must persuade us that FERC's actions were arbitrary or capricious. "Highly deferential," the arbitrary and capricious standard "presumes the validity of agency action." National Mining Ass'n. v. Mine Safety and Health Admin., 116 F.3d 520, 536 (1997). Where, as here, the issue before us "requires a high level of technical expertise, we must defer to the informed discretion of the responsible federal agencies." Marsh v. Oregon Natural Resources Council, 490 U.S. 360, 377 (1989) (internal quotation marks omitted). It is not enough for petitioners to convince us of the reasonableness of their views, see UDC, 88 F.3d at 1169 ("The existence of a second reasonable course of action does not invalidate an agency's determination."); those arguments should be presented to FERC, whose commissioners are appointed by the President and confirmed by the Senate with the expectation that they, not Article III courts, will make policy judgments.

To prevail in this court, petitioners must demonstrate that FERC's policy judgments are arbitrary or capricious, a heavy burden indeed. See National Treasury Employees Union v. Hefler, 53 F.3d 1289, 1292 (D.C. Cir. 1995) ("The 'scope' of review under the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency.") (quoting Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983.)). With this very deferential scope of review in mind, we turn to petitioners' arguments.

a. POSCR's challenges to the stranded cost formula

Reasoning that it would be burdensome to identify each and every asset that would become underutilized as a result of Order 888, FERC adopted a "revenues lost" formula to determine a departing customer's stranded cost obligation. Order 888, ¶ 31,036 at 31,839. For each year a utility can prove that it had a reasonable expectation of continued service to a particular customer, the formula calculates the customer's stranded cost obligation by subtracting the com-

[Page 67]petitive market value of the power the customer would have purchased from the utility (as estimated by the utility) from the amount the customer would have paid had it remained a generation customer of the utility (based on FERC-approved rates that the customer paid the prior three years). Id. at 31,839-40.

POSCR claims that this formula gives utilities no incentive to mitigate their stranded costs. Not so. The formula automatically provides such an incentive by subtracting from utilities' recovery the market price of the power—utilities that fail to sell the power at market prices will not recover their full costs. POSCR also claims that the formula fails accurately to measure stranded costs because it is based on an estimate of those costs at one point in time. Responding, FERC explained why it rejected a "true-up" provision that would have made adjustments to the amount the customer owed to reflect market conditions over the reasonable expectation period. According to FERC, such an approach would have created enormous uncertainty, outweighing any potential increase in accuracy. See Order 888-A, ¶ 31,048 at 30,427-28. POSCR has offered no basis for us to question this reasoning.

POSCR's claim that the formula gives utilities an incentive to minimize their estimate of the market value of the power the customer would have purchased is similarly groundless. To avoid precisely this result, Order 888 gives customers an option to either market or broker the capacity and associated energy they would have purchased from their historic utility, effectively reducing their stranded cost obligations by the difference between the actual market value of the power and the utility's estimate of the market value. See Order 888, ¶ 31,036 at 31,844. Order 888 also gives customers an option to substitute the price of power under the customer's contract with a new supplier for the utility's estimate of the market value. See id.

One final point. Throughout its brief and at oral argument, POSCR consistently referred to stranded costs as "imprudently incurred costs." Although it never developed this [Page 68] argument, we think it worth noting that all costs included in customers' stranded cost obligations are based on FERC-approved rates and were included in utility rate bases as assignable to particular customers. To us, this means that these costs are legitimate, prudent, and verifiable.

b. Inclusion of known and measurable costs

The IOUs take issue with Order 888's stranded cost recovery formula because the estimate of the price the customer would have paid for the power is based on rates for the prior three years; according to the IOUs, this approach fails to consider known and measurable costs resulting from regulatory mandates that may have been deferred pursuant to filed rate schedules and FERC-approved settlements. The costs they cite include deferred costs of generation that have already been approved for inclusion in the rate base, costs relating to approved qualifying facility contracts, and government-imposed costs such as deferred taxes and nuclear decommissioning.

Although it is true that the revenue calculation measures only current rates and not deferred costs, Order 888 allows customers and utilities to file for a change in the rates before the customer's requirements contract terminates; in such cases, FERC will calculate the customer's stranded cost obligation based on those new rates. See Order 888-A, ¶ N31,048 at 30,427. While seeking to avoid detailed listings of specific costs that may become stranded, FERC has adequately preserved utilities' ability to include known, measurable costs in revenue estimates through a ratemaking proceeding.

c. Treatment of energy costs in the market option

The IOUs challenge FERC's treatment of energy costs in the market option. To mitigate utilities' incentives to

minimize their estimates of the market value of the power (the competitive market value estimate or "CMVE"), Order 888 affords customers an option to buy the power stranded by their departure from the utility and resell it. Order 888, ¶ 31,036 at 31,844. Customers would purchase generation [Page 69] capacity at the utility's estimated market value of the capacity and associated energy at average system variable cost. Id. at 31,845. Thus if a customer believes that a utility is underestimating the price at which it could sell the power, the customer can buy the power and then resell it. While customers exercising this option would still have to pay their stranded cost obligation as calculated under the formula, they would effectively offset the obligation by keeping the profit on the resale of the power. Id. at 31,845 n.879.

The IOUs contend that allowing customers to pay average variable cost for the associated energy is inconsistent with Order 888's definition of the CMVE, which equals the market value of both the generation capacity and associated energy. See id. at 31,839 (defining CMVE as "the utility's estimate of the average annual revenues ... that it can receive by selling the released capacity and associated energy, based on a market analysis performed by the utility"). Customers could receive a windfall, the IOUs claim, by exercising the market option although they will pay average variable cost for the associated energy, they will be able to resell it at the presumably higher market price. At the same time, utilities will be unable to recover the full market value of the power because they will be forced to sell the associated energy at cost.

Responding to this argument in Order 888-A, FERC offered two justifications for allowing customers to purchase the associated energy at average variable cost. First, because the capacity being marketed would not generally be associated with a single asset, customers exercising this option are purchasing a "slice of the system" and thus should pay average variable cost. Second, customers should be able

to purchase energy at the price they currently pay, typically average variable cost. See Order 888-A, ¶ 31,048 at 30,433. But neither explanation responds to the IOUs argument that defining CMVE as the market price of both the capacity and associated energy is inconsistent with allowing customers exercising the market option to purchase associated energy at average variable cost. In its brief in this court, FERC continues to misapprehend the IOUs' argument, largely reit- [Page 70] erating the same arguments and failing to address the inconsistency.

The market option's stated intention is to reduce a utility's incentive to understate the CMVE. See Order 888, ¶ 31,036 at 31,842. If it did understate the CMVE, then customers could buy the power from the utility and resell it, keeping the difference. But FERC's policy of allowing customers to purchase the associated energy at cost gives customers an incentive to exercise the market option even when a utility has appropriately estimated CMVE because they can buy the energy at cost and resell it at the presumably higher market price. FERC's failure to explain whether it intended this result and if so, the justification for permitting customers to receive a windfall while undercompensating utilities constitutes a failure of reasoned decisionmaking. See AGD, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). We therefore vacate this portion of the orders and remand the issue to FERC for further consideration.

d. Rescission of notice of termination provision

Until FERC issued Orders 888 and 889, it had required parties to power sales contracts to notify it sixty days prior to cancellation of a contract or termination of a contract by its own terms. See 18 C.F.R. § 35.15 (repealed by Order 888). Orders 888 and 889 eliminate the requirement that parties notify FERC in advance when a contract terminates by its own terms, but only with respect to contracts executed after

July 9, 1996; in other cases of contract cancellation or termination, parties must still notify FERC in advance. See 18 C.F.R. § 35.15 (1999). TDU petitioners claim that in rescinding the notice requirement, FERC ignored the fact that utilities still have substantial market power. That some utilities retain market power in generation, however, does not undermine Orders 888 and 889. Through these orders, FERC sought to move the electricity industry toward competition; by providing an open access mechanism through which buyers may purchase power from suppliers other than trans-[Page 71]mitting utilities, FERC substantially reduced. Utilities' market power. Eliminating the notice requirement furthered that policy. Moreover, customers who believe termination of their contracts is unjust can seek relief from FERC pursuant to section 206 of the FPA; See Order 888-A, ¶ 31,048 at 30,393.

e. Provision for benefits lost

The TDU petitioners claim that FERC acted arbitrarily and capriciously by failing to provide a mechanism for customers purchasing power at below-market rates to preserve those rates at the termination of their contract with their historic utility. Just as utilities may have expectations of continued service to particular customers, the TDU petitioners contend, customers may have reasonable expectations of continuing to receive wholesale requirements service from their historic utility at cost-based rates. Order 888-A says that the Commission does "not have a sufficient basis on which to make generic findings that customers under such contracts may be entitled to extend a contract at the existing rate." Order 888-A, ¶ 31,048 at 30,393 (emphasis removed). Moreover, the order explains, "the consequences of customers' expectations as a general matter would not have the potential to shift significant costs to other customers," whereas utilities' failure to recover stranded costs could potentially shift the costs to other customers. Id.

We think that FERC has adequately explained why it chose not to provide for benefits-lost recovery in Order 888. Most important, FERC has not foreclosed customers in this situation from seeking relief As Order 888-A explains, a customer may "exercise its procedural rights under section 206 to show that the contract should be extended at the existing contract rate, or [ ] make such a showing in the context of a utility's proposed termination of a contract pursuant to the section 35.15 notice of termination (approval) requirement." Id. (footnote omitted). Given that agencies "enjoy[ ] broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures ... and priorities," we think FERC's refusal to promulgate a generic rule on this issue was entirely reasonable. Mobil Oil Explo-[Page 72]ration & Producing Southeast, Inc. v. United Distrib. Cos., 498 U.S. 211, 230 (1990).

B. Retail Stranded Costs

Recognizing state agency authority to address stranded costs that relate to retail power sales, Order 888 limits FERC's role as a forum for the recovery of these costs to two situations: when customers take advantage of state-ordered wheeling to reach new power suppliers and when former retail customers become wholesale customers through what is known as municipalization or municipal annexation. See Order 888-A, ¶ 31,048 at 30,402, 30,410. In the former scenario, FERC will consider proposals for the recovery of stranded costs only when the appropriate state regulatory commission lacks authority to do so; in the latter situation, FERC will serve as the primary forum for resolution of stranded cost claims.

1. Stranded Costs Arising from Retail Wheeling

Stranded costs may result from state unbundling of retail sales, where retail customers take advantage of state-ordered retail wheeling to reach new generation suppliers. See Order 888, ¶ 31,036 at 31,819. Observing that both FERC and the

states have authority to address these stranded costs, Order 888 explains that:

> [B]ecause it is a state decision to permit or require the retail wheeling that causes retail stranded costs to occur, we will leave it to state regulatory authorities to deal with any stranded costs occasioned by retail wheeling. The only circumstance in which we will entertain requests to recover stranded costs caused by retail wheeling is when the state regulatory authority does not have authority under state law to address stranded costs when the retail wheeling is required.

Order 888, ¶ 31,036 at 31,824-25 (footnote omitted). FERC will provide for recovery of those stranded costs through the transmission rate the former supplying utility charges the departing customer. Order 888-A, ¶ 31,048 at 30,410. (As discussed in Section III supra, FERC has jurisdiction over [Page 73]the transmission component of unbundled retail sales.). In evaluating claims for stranded cost recovery, FERC will use the same standards as it applies with respect to wholesale stranded costs (i.e., it will require utilities to demonstrate a reasonable expectation of continued service). See Order 888, ¶ 31,036 at 31,819 n.722.

Two sets of petitioners challenge FERC's retail stranded cost recovery provisions from opposite sides. The States and POSCR contend that FERC exceeded its jurisdiction by asserting rate authority over retail stranded costs. The IOUs argue that FERC abdicated its statutory authority by failing to agree to consider all proposals for recovery of stranded costs that arise from retail wheeling. Because we think FERC has appropriately exercised its jurisdiction, we reject both claims.

a. FERC's jurisdiction over retail stranded costs

The States' and POSCR's arguments boil down to the following: Because retail stranded costs relate primarily to

facilities used for retail generation, and because section 201(b) of the FPA explicitly excludes these facilities from FERC's jurisdiction, FERC may not provide for recovery of these costs in FERC-jurisdictional rates. Unbundling electricity sales, they argue, cannot alter the jurisdictional status of these costs.

As an initial matter, we agree with FERC that petitioners confuse costs and rates. Rates are jurisdictional; costs are not. As Order 888-A explains:

> [T]here are rarely separate retail and wholesale generating facilities. Retail customers and wholesale requirements customers get energy from the same facilities, each buying a "slice of the system." Typically all generating assets go into both the retail and the wholesale rate bases for determining retail and wholesale rates. Rates are determined by allocating the total generating costs among customer classes. The parties confuse the issue before us to the extent they suggest that state commissions, not this Commission, have "jurisdiction" over cer-[Page 74]tain "costs." Neither the state commissions nor this Commission has exclusive jurisdiction over "costs." Each regulatory authority has jurisdiction to determine "rates" for services subject to its jurisdiction and, in determining rates, may take into account all of the costs incurred by the utility.

Order 888-A, ¶ 31,048 at 30,414. In other words, as FERC explained in its brief "regulatory authorities do not carve out so-called 'wholesale costs' that only FERC can take into account in determining rates subject to its jurisdiction or so-called 'retail costs' that only a state commission can take into account in determining rates subject to state jurisdiction." Instead, "[u]nder historical cost-of-service ratemaking, each regulatory authority, in exercising its respective ratemaking jurisdiction, reviews the total costs incurred by a utility to

provide service and makes its separate and independent determination of what costs may be recovered through rates within its jurisdiction." Order 888-A, ¶ 31,048 at 30,414.

Thus, while petitioners correctly point out that section 201(b) of the FPA denies FERC jurisdiction over "facilities used for the generation of electric energy," that provision does not necessarily prevent FERC from including costs relating to generating facilities in transmission rates, over which FERC indisputably has jurisdiction. 16 U.S.C. § 824(b). This is so because this part of section 201(b) is modified by the phrase "except as specifically provided in this subchapter and subchapter III of this chapter." Id. Given that section 201(a) grants FERC jurisdiction over "the transmission of electric energy in interstate commerce" and, therefore, over transmission rates, 16 U.S.C. § 824(a), FERC may exercise jurisdiction over generation facilities to the extent necessary to regulate interstate transmission.

This is exactly the construction that we gave section 201(b) in Mississippi Industries v. FERC, 808 F.2d 1525, 1543-45 (D.C. Cir. 1987) (subsequent history omitted). There, petitioners challenged FERC's authority to reallocate costs relating to generation facilities among utilities that were parties to a power sales agreement. Justifying its authority to reallo-[Page 75]cate such costs, FERC relied on its "undisputed jurisdiction over interstate sales of electric energy at wholesale." Id. at 1543. We agreed: "[A]lthough allocating cost does, to some extent, result in the 'regulation of matters relating to generation,' such regulation is valid under the FPA when it is the byproduct of a legitimate exercise of FERC's power to regulate wholesale rates." Id. In reaching this conclusion, we rejected petitioners' argument that "the statutory prohibition of federal regulation of [generation] facilities in section 201(b) becomes meaningless if FERC is permitted to allocate the costs of a plant," given FERC's undisputed responsibility to regulate the wholesale sale of power. Id. at 1543-44. Under Mississippi Industries,

then, FERC may regulate costs relating to generation facilities if such regulation "is the byproduct of a legitimate exercise of FERC's power to" regulate interstate transmission. Id. at 1543. Because FERC indisputably has jurisdiction over transmission rates, Mississippi Industries also disposes of Petitioners' argument that FERC's retail stranded cost recovery provisions run afoul of section 201(a) of the FPA, which provides that "Federal regulation [shall] extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a).

Attempting to distinguish Mississippi Industries, petitioners point out that the case "involved authority to allocate generation costs to a wholesale sales rate (which may, of course, include generation costs)." True, but Mississippi Industries provides clear authority for the proposition that there is no per se jurisdictional bar to FERC's including generation costs in jurisdictional rates, whether wholesale sales rates or transmission rates. Thus narrowed, the question before us is this: Is inclusion of stranded costs relating to generation facilities in transmission rates the byproduct of a legitimate exercise of FERC's authority over transmission rates? In most cases the answer would be no, but given the highly unusual circumstances of this case, we think the answer is yes. Just as FERC may include generation-related wholesale stranded costs in transmission rates (see Section V.A.1.b), it may include generation-related retail stranded costs in transmission rates. That retail stranded costs were [Page 76]originally reflected in state-jurisdictional retail sales rates does not change the analysis, for in both cases the stranded costs can be viewed as "costs" of providing transmission services: "While such costs are not a cost of operating the physical transmission system, nevertheless, they are an economic cost incurred as a result of being required to provide retail transmission." Order 888-A, ¶ 31,048 at 30,414 n.708. While we agree that generation-related retail costs are not typically "costs" relating to transmission services, the fundamental changes

wrought by state-ordered retail wheeling, as well as the narrow circumstances in which FERC will consider stranded cost recovery claims, justify the conclusion that these costs are costs of providing transmission service.

Petitioners claim that by agreeing to consider retail stranded cost recovery claims, FERC has unduly interfered with state legislative processes and decisions. We disagree. FERC has limited its "interference" to instances where state commissions have no authority even to address stranded cost recovery claims. Describing its role as limited to "fill[ing] any regulatory gap," FERC made it clear that it will deny consideration to any utility seeking stranded cost recovery "if a state regulatory authority with authority to address retail wheeling stranded costs has in fact addressed such costs, regardless of whether the state regulatory authority has allowed full recovery, partial recovery, or no recovery." Order 888-A, ¶31,048 at 30,415. Under these circumstances, it can hardly be said that FERC has usurped state authority.

b. FERC's refusal to assert jurisdiction over all retail stranded costs.

Contending that FERC did not go far enough, the IOUs challenge the agency's refusal to consider claims for stranded costs resulting from state-ordered retail wheeling unless the relevant state regulatory commission lacks authority to address such claims. They claim that FERC should have agreed to consider proposals for retail stranded cost recovery whether or not the state commission had authority to address the claim, and even whether or not a state commission with such authority had already addressed the claim. In support [Page 77]of their position the IOUs advance three related arguments. They allege first that by concluding that it had jurisdiction over retail stranded costs but declining to exercise it, FERC abdicated its legal authority. Second, they say, FERC violated its statutory obligation to ensure just and reasonable rates. And finally, they contend that FERC erred

in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission ordered in Order 888.

With respect to their first argument, the IOUs claim that once FERC determined that it had jurisdiction over retail stranded costs, the agency had to exercise that jurisdiction. In making this argument, the IOUs make the same mistake POSCR made: They confuse FERC jurisdiction over costs with its jurisdiction over rates. FERC has not "concluded that it shares jurisdiction over retail stranded costs with the states," as the IOUs assert. As we explained above, "costs" are not jurisdictional. The FPA speaks not in terms of "costs," but in terms of "rates," requiring FERC to ensure that rates are just, reasonable, and not unduly discriminatory. FERC indisputably has jurisdiction over interstate transmission rates. In essence, then, the IOUs claim that FERC has no discretion to leave retail stranded cost recovery to state authorities.

We review claims that an agency lacks discretion to follow (or decline to follow) a certain course of action by examining the agency's governing statute as well as its own regulations. See, e.g., National Wildlife Federation v. Browner, 127 F.3d 1126, 1130 (D.C. Cir. 1997)(concluding that agency regulations do not require EPA to review and approve or disapprove a state's decision to maintain existing water quality standards); NRDC v. EPA, 25 F.3d 1063, 1069-70 (D.C. Cir. 1994) (holding that neither the governing statute nor relevant regulations impose a mandatory duty on EPA to list all wastes that exhibit a hazardous characteristic; statute gives EPA "substantial room to exercise its expertise in determining the appropriate grounds for listing"). The IOUs have failed to point to any statutory provision that robs FERC of discretion to decide, as a matter of policy, that state regulato-[Page 78]ry commissions should serve as the primary forum for retail stranded cost recovery. Our own examination of the FPA reveals no such provision either.

Sections of the statute giving FERC jurisdiction over transmission in interstate commerce, 16 U.S.C. § 824(a), and requiring FERC to ensure that rates are just and reasonable, 16 U.S.C. § 824d(a), do not alone create a mandatory duty to consider proposals for retail stranded cost recovery.

The two Supreme Court cases the IOUs rely on provide no support for their position, for in both cases the agencies, unlike FERC in this case, failed to comply with a specific statutory mandate. In MCI v. AT&T, 512 U.S. 218 (1994), the Supreme Court held that the FCC could not exempt certain communication common carriers from filing a tariff; the statute specified that all carriers must file tariffs. Similarly, in FPC v. Texaco, Inc., 417 U.S. 380 (1974), the Supreme Court determined that the FPC could not exempt certain producers from the statute's requirement that rates be just and reasonable. Under these cases, FERC would abdicate its statutory obligations if it, for example, exempted certain utilities from the requirement that rates be just and reasonable (as in Texaco), or if it refused to review transmission rate filings altogether. These cases do not hold that in carrying out its statutory obligations, FERC has no discretion to determine as a matter of policy that states are better positioned to address costs originally included in retail rate cases. What the IOUs suggest that because FERC has authority to address retail stranded costs through transmission rates, it must exercise that authority—is simply not the law.

As an alternative to their legal argument, the IOUs claim that FERC acted arbitrarily and capriciously in determining that just and reasonable transmission rates include retail stranded cost recovery in some circumstances but not in others. Their argument goes like this: Section 201(b)(1) of the FPA gives FERC exclusive jurisdiction over transmission of electric energy in interstate commerce. Under section 205, FERC must set just and reasonable rates. In addition, sections 205 and 206 prohibit undue discrimination. Thus,

[Page 79]the IOUs argue, "[b]y approving different transmission rates, some including stranded cost recovery (e.g., municipalization), and others without (e.g., retail wheeling or bypass), FERC is sanctioning arbitrary and capricious differences in violation of the FPA."

In making this argument, the IOUs ignore the wide discretion the FPA affords FERC to determine what constitute "just and reasonable rates" and "undue discrimination," as well as the unusual circumstances created by an industry change as fundamental as Order 888's open access requirement. Just because some transmission rates include retail stranded costs while others do not does not alone make Order 888 arbitrary and capricious; rather, petitioners must show that there is no reason for the difference. Cf. AGD, 824 F.2d at 1009 ("[T]he mere fact of a rate disparity is not enough to constitute unlawful discrimination.") (internal quotation marks omitted). We think FERC has provided a convincing explanation for the difference. "Recovery of this type of cost through a transmission rate is obviously not the norm," explains Order 888-A, "but is necessitated by the need to deal with the transition costs associated with this Rule." Order 888-A, ¶ 31,048 at 30,418. Only in situations where state regulatory commissions lack authority to award stranded costs will FERC include these costs in transmission rates. Otherwise, customers would be able to avoid their stranded cost obligations, leaving utility shareholders or remaining customers to bear the costs.

The IOUs reliance on the natural gas restructuring cases is misplaced. Setting aside the extraordinary nature of take-or-pay liabilities as compared to the stranded costs at issue here, AGD required only that FERC address the take-or-pay liabilities that the pipelines had incurred. See AGD, 824 F.2d at 1030 ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."). That is exactly

what Order 888 does with respect to stranded costs. While FERC has not agreed to serve as the forum for recovery of these costs in all situations, neither the FPA nor the natural gas cases requires it to do so. By ensuring that utilities have a forum in which [Page 80]to bring claims for retail stranded cost recovery, FERC has done just what AGD requires.

Nor do we find merit in the IOUs' argument that FERC erred in concluding that stranded costs resulting from retail wheeling lack a direct nexus to the open access transmission mandated by Order 888. FERC's decision that state regulatory commissions should address retail stranded costs rested on its conclusion that state-ordered wheeling, not FERC-mandated open access transmission, causes those costs to become stranded. See Order 888-A, ¶ 31,048 at 30,410. Recognizing a "limited" nexus between retail stranded costs and FERC-mandated open access stemming from FERC's jurisdiction over transmission rates and the resulting authority to award stranded costs, FERC nonetheless found no causal nexus between stranded costs and FERC-ordered transmission. Id. at 30,419. The lack of a direct causal nexus differentiates retail stranded costs from retail turned-wholesale stranded costs (see infra Section V.B.2).

Taking issue with this reasoning, the IOUs contend that FERC ignored "the central role played by the federal government" in shaping the electric energy industry. Because retail wheeling, according to the IOUs, is "a direct result of a federally created system of increased competition," FERC must take responsibility for all retail stranded costs.

Nowhere does FERC contest the nexus between state ordered wheeling and order 888's open access requirement. But the existence of a nexus does not require FERC to address stranded costs in light of the fact that in most instances state regulatory commissions will have authority to do so. Indeed because the costs were originally included in

retail rate bases, state agencies are better positioned to consider them. Given that it is state-ordered wheeling that most directly causes retail costs to become stranded, we find no reason to disturb FERC's judgment.

2. Stranded Costs Relating to Retail-Turned-Wholesale Customers

FERC concluded that open access transmission may, encourage what is known as "municipalization," where a town [Page 81] condemns a utility's distribution plant, becomes a wholesale customer of the utility, and utilizes open access transmission to purchase power on the competitive market. Concluding that costs incurred to serve former retail customers may become stranded due to the municipality's (the new wholesaler's) utilization of open access transmission, FERC decided to serve as the primary forum for resolution of stranded costs claims relating to new municipalizations. See Order 888-A, ¶ 31,048 at 30,402. FERC also decided to serve as the primary forum "in a discrete set of municipal annexation cases"—i.e., cases involving "existing municipal utilities that annex retail customer service territories and, through the availability of Commission-required transmission access, use the transmission system of the annexed customers' former supplier to access new suppliers to serve the annexed load." Order 888-B, ¶ 61,248 at 62,102. In such cases, FERC will determine on a case-by-case basis whether there exists the requisite nexus between municipal annexation and open access transmission. Recognizing that state regulatory authorities may be the first to address claims for stranded cost recovery in the retail-turned-wholesale scenario (FERC's label for new municipalizations and municipal annexations), FERC stated that it "will take into account state findings on cost determinations and will give great weight in [its] proceedings to a state's view of what might be recoverable." Id. at 62,105 (internal quotation marks omitted).

This issue provoked the only dissents to Order 888. Although neither dissenting commissioner disputed FERC's jurisdiction to allow recovery of these stranded costs, both faulted FERC for second-guessing state authorities regarding stranded costs. They thought that FERC should have acted as the forum for adjudicating these stranded cost issues only when state authorities failed to act altogether. See Order 888, ¶ 31,036 at 31,904-07 (Commissioner Hoecker concurring in part and dissenting in part); id. at 31,907 (Commissioner Massey dissenting in part).

Unlike the dissenters, both the States and POSCR challenge FERC's assertion of jurisdiction. According to the [Page 82]States, FERC usurped their role as protectors of retail customers by potentially undermining their rate treatment of retail costs, POSCR makes three arguments. Advancing claims similar to its arguments about stranded costs resulting from state-ordered retail wheeling (see Section V.B.1.a. supra), POSCR first contends, relying again on section 201(b), that FERC lacks jurisdiction to award retail stranded costs in the retail-turned-wholesale scenario. Second, it claims, FERC failed to weigh properly the adverse effects of Order 888 on franchise competition between utilities and municipalities. Finally, relying on the Hoecker and Massey dissents, POSCR argues that FERC acted arbitrarily and capriciously by declaring itself to be the primary forum for retail-turned-wholesale stranded cost claims. For their part, the IOUs fault FERC's failure to consider claims for recovery in the so-called "bypass" scenario. We address th se arguments in turn.

The States begin their argument by asserting that "[w]hen retail utility customers leave the utility's system because of municipalization the costs stranded by the customers' migration normally are not allocable ... to whatever wholesale utility service might be sold to the city for resale." While this may have been true in the past, the States' argument ignores FERC's conclusion that it is open

access transmission that makes municipalization feasible. Because FERC has determined that it will consider proposals for stranded cost recovery only when there is a direct nexus between municipalization and open access transmission, we see no basis for the States claim that FERC will "override Congress's instruction that the states be permitted to protect retail customers."

The answer to POSCR's first argument—that section 201(b) precludes FERC from awarding stranded costs in the retail turned-wholesale context—appears in our discussion of FERC's jurisdiction to address retail stranded costs resulting from state ordered retail wheeling. See Section V.B.1.a. supra. Because a town becomes a wholesale customer of the historic supplying utility when it municipalizes, FERC's exclusive jurisdiction over all aspects of wholesale sales gives [Page 83]FERC the authority it needs to include generation-related costs in rates, including even costs originally incurred to provide retail service. We find no reason to question FERC's decision to allocate stranded costs caused by retail-turned-wholesale customers to the cost of providing wholesale service subject to its jurisdiction. As in the retail wheeling context, these stranded costs are properly viewed as "costs" of the former supplying utility's, provision of open access transmission service. With respect to new municipalizations, the retail-turned-wholesale customer is able to reach a new generation supplier only because of open access transmission. And with respect to municipal annexations, FERC will require utilities to demonstrate a nexus between the annexation and open access transmission.

POSCR's second argument relates to what is known as "franchise competition." According to POSCR, franchise competition occurs "when a privately-owned utility is threatened by the prospect that a municipality may exercise powers of eminent domain to take over the utility's operations." POSCR argues that stranded cost recovery could impede franchise competition, which it says FERC has

always encouraged. Although this might well be true, the possibility that potential stranded cost liability could deter municipalities from taking advantage of open access does not undermine Order 888. As Order 888-A explains, "the purpose of the stranded cost policy is neither to encourage nor to discourage municipalization, but rather to facilitate a fair transition to competition and to ensure stability in the industry during that transition." Order 888-A, ¶ 31,048 at 30,405.

We turn finally to POSCR's claim that FERC acted arbitrarily and capriciously by declaring itself the primary forum for recovery of retail-turned-wholesale stranded costs. Asserting that FERC's action implicitly undermines state decisionmaking and encourages forum shopping, POSCR claims that Order 888's treatment of the retail-turned-wholesale scenario contravenes agency precedent and conflicts with the agency's decision to leave to the states the consideration of those stranded costs resulting from state-ordered wheeling.

[Page 84]While FERC did leave resolution of claims for wholesale-turned-retail stranded costs to the states in United Illuminating Co., 63 FERC ¶ 61,212 (1993), a pre-Order 888 case addressing a particular utility's application for stranded cost recovery, Order 888-A explains that, after reanalyzing the stranded cost problem, FERC concluded that "where such costs are stranded as a direct result of Commission-mandated wholesale transmission access, these costs should be viewed as costs of the transition to competitive wholesale bulk power markets and this Commission should be the primary forum for addressing their recovery." Order 888-A, ¶ 31,048 at 30,407. In our view, this explanation adequately distinguishes between recovery of stranded costs from retail customers and recovery from retail-turned-wholesale customers. In the former situation customers remain retail customers subject to state jurisdiction; in the latter situation, customers become wholesale customers subject to FERC's

exclusive jurisdiction. This very different result justifies FERC'S different treatment of the two situations.

The IOUs argue that FERC should have provided for stranded cost recovery from a retail-turned-wholesale customer who ceases to purchase power from a utility but does not use that utility's transmission service to reach another power supplier—the so-called "bypass" scenario. This argument requires little discussion. In declining to provide a mechanism for the recovery of bypass stranded costs, FERC explained that "Order No. 888 does not by its terms bar the recovery of costs that do not result from the use of Commission-required transmission access. Utilities may, as before, seek recovery of such non-open-access-related costs on a case-by-case basis in individual rate proceedings. The Commission will not prejudge those issues here." Id. at 30,409. Given FERC's discretion to proceed through adjudication rather than by generic rule, see SEC v. Chenery Corp., 332 U.S. 194, 201-03 (1947), the IOUs challenge is without merit.

* * *

As evidenced by the numerous petitions for review, FERC faced an enormously difficult task in fashioning a stranded [Page 85]cost recovery mechanism that fairly compensates utilities for past investments while transitioning the electricity industry to competition. FERC has done an admirable job. Producing a comprehensive, evenhanded record and carefully considering all commenters' claims, it adopted a stranded cost recovery policy that accomplishes its stated objectives, complies with the FPA, conforms to our case law, and reasonably accommodates all competing interests. No doubt, there were alternative approaches to stranded cost recovery—petitioners have pointed to several. No doubt some aspects of Order 888 could have been better supported. But given the extremely technical nature of these issues, as well as our highly deferential standard of review, we find no basis for questioning FERC's approach.

Although Order 888 may be characterized in many ways, it can hardly be said to be either arbitrary or capricious.

VI. CREDITS FOR CUSTOMER-OWNED FACILITIES AND BEHIND-THE-METER GENERATION

The Commission's Open Access Tariff requires that public utilities—or "transmission providers"—offer "network integration transmission service." This requirement is one of the key elements in the Commission's attempt to "remove impediments to competition in the wholesale bulk power marketplace," Order 888, ¶ 31,036 at 31,634. Network service allows a customer for instance, a municipal utility to use a transmission system in a manner comparable to the way the transmission provider utilizes its system to move power from its generators to its native load customers.[11] See Order 888, [Page 86] ¶ 31,036 at 31,736; id. at 31,751; Order 888-A, ¶ 31,048 at 30,260 n.247; id. at 30,325.[12] With network service, resources located throughout the system serve loads dispersed throughout the system. For this, the transmission provider incorporates the network customer's resources and loads (projected over a minimum ten-year period) into its own long term planning. Because network service ultimately provides the customer with the same full system ability for transmitting power as the transmission owner, the

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11 "Load" may be defined as "[t]he total demand for service on a utility system at any given time." Public Utilities Reports Glossary For Utility Management 84 (1992); See Also Carl Pechman, Regulating Power: The Economics of Electricity In The Information Age 11 (1993). The Tariff defines "native load customers" as the "wholesale and retail power customers of the Transmission Provider on whose behalf the Transmission Provider, by statute, franchise, regulatory requirement or contract, has undertaken an obligation to construct and operate the Transmission Provider's system to meet the reliable electric needs of such customers." Order 888-A, ¶ 31,048 at 30,508.

12 Public utilities must also offer point-to-point service, that is, transmis-sion service-reserved and/or scheduled between specified points of receipt and delivery. Order 888-A, ¶ 31,048 at 30,508.

Commission required that costs be allocated on the basis of a ratio of the network customers load to the transmission provider's entire load on its transmission system. A group of petitioners, led by Florida Municipal Power Agency (FMPA), challenge the Commission's use of this "load-ratio pricing."

The FMPA petitioners do not object to load-ratio pricing as such. In fact they think it "is a good method to allocate the costs of a transmission network among network owners or users," Brief of Credits for Customer-Owned Facilities, etc., at 3-4 ("Credits Brief"). Their principal complaint, repeated many times and in many ways throughout their briefs, stems from their view that as a practical matter the commission required that the network customer's total load be used in calculating the ratio,[13] even though some customers it sells power from local, 'behind the meter generation and transmission, or obtain power from more than one transmission system...." Id. at 8.[14] The FMPA petitioners say this [Page 87]allows "transmission providers to charge wholesale customers for network transmission that they do not want, need or use to provide electric power service to their customers." Id. at 18.

The Commission provided some relief in response to these complaints, but not enough to satisfy the FMPA petitioners. "Because of the diverse concerns raised by the commenters," the Commission wrote in the preamble to Order No. 888, "we are unable to resolve on the basis of this record the extent to which, or under what circumstances, cost

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13 The Commission did not actually require a customer to designate its total load to obtain network service: a customer may exclude all—not merely part—of its load at a discrete delivery point. See Order 888-A, ¶ 31,048 at 30,256-62.

14 Behind the meter generation [and transmission] means generation for transmission] located on the customer's side of the point of delivery." Order 888-A, ¶ 31,048 at 30,254 n.230.

credits related to customer-owned facilities would be appropriate under an open-access transmission tariff," Order 888, ¶ 31,036 at 31,742. Rather, this will be done on a case-by-case basis. The Commission warned, however, that mere interconnection between a customer's facilities and the transmission provider's facilities will not be sufficient to warrant a cost credit. Relying on Florida Municipal Power Agency v. Florida Power & Light Co., 67 F.E.R.C ¶ 61,167 (1994) (FMPA I), modified, 74 F.E.R.C. ¶ 61,006 (1996) (FMPA II), the Commission required the customer to demonstrate that its "transmission facilities are integrated with the transmission system of the transmission provider" and provide additional benefits to the transmission grid in terms of capability and reliability, and [are] relied upon for the coordinated operation of the grid." Order 888, ¶ 31,036 at 31,742; Order 888-A, ¶ 31,048 at 30,271. The Commission did, however, guarantee credits for new, integrated transmission facilities built by a customer if jointly planned with the transmission provider.

We detect nothing in the arguments of the FMPA petitioners to warrant setting aside this aspect of the Commission's rule. It is true that as the owners of generation and transmission facilities, any one of these petitioners can satisfy some of its needs. But network service, as the Commission defined it, means that network customers can call upon the transmission provider to supply not just some, but all of their load at any given moment, when for instance they experience blackouts or brownouts. The Commission decided that if a customer does not desire such full network service for its entire load, it may exclude loads at discrete delivery points [Page 88]and purchase point-to-point service instead. What it cannot do is split loads at delivery points. The FMPA petitioners object to the Commission's refusal to allow a split system, but their objection is not well-taken. They ignore the technical problems with a split system, stemming partly from the manner in which electrons flow and the impossibility of isolating loads from the transmission

providers system. See FPC v. Florida Power & Light, 404 U.S. 453 (1972). Furthermore, "such a split system creates the potential for a customer to 'game the system' thereby evading some or all of its load-ratio cost responsibility for network services." Order 888-A, ¶ 31,048 at 30,259.[15] The FMPA petitioners label this prospect a "fiction," but offer neither evidence nor reasoning to counter the Commissions expert judgment.[16]

As to credits, these petitioners maintain that if the Commission is going to use total "load-ratio pricing with Network Load defined as total customer load, simultaneous credits are required." Credits Brief at 41. What they mean by credits is reduced prices for any and all behind-the-meter facilities they own. The Commission's rejection of this blanket approach is well-supported. Credit may be given, but not automatically. The question can only be determined on a case-by-case basis because it depends on whether the customers facilities are truly integrated with the transmission system, rather than merely interconnected. Only if they are [Page 89]integrated will the transmission system benefit and only then, the Commission decided, should credits—which shift the costs of the customers facilities to the transmission provider's customers—be allowed. Order 888-A, ¶ 31,048 at

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15 Load-ratio cost responsibility is based on the customer's contribution to the transmission system peak each month. With a split system a customer could, at the time of the monthly system peak, increase its behind-the-meter generation in order to decrease its load-ratio cost responsibility, while making significant use of the transmission system throughout the rest of the month. See Order 888-A, ¶ 31,048 at 30,259 nn.244 & 245.

16 Petitioners claim that Florida Power Co., 81 F.E.R.C. ¶ 61,247 (1997), decided after Order No. 888, shows that it is not "necessary for customers to purchase amounts of network transmission equal to their entire load behind a delivery point." Credits Brief at 30. It shows no such thing. The case involved not network integration transmission service, but a sort of hybrid service called "network contract demand transmission service."

30,271. Petitioners call the Commission's rule in this regard "an unexplained and inexplicable retreat from FMPA v. FPL." Credits Brief at 42. It is nothing of the sort. The Commission made this abundantly clear. In FMPA I the Commission said that "if [a customer] has transmission facilities that will operate as part of the integrated transmission system, a credit would be reasonable." 67 F.E.R.C. at 61,482 n.76. And in FMPA II the Commission said that mere interconnection does not equal integration and that integration must be determined case by case. 74 F.E.R.C. at 61,010. This is completely consistent with the Commission's resolution of the credits issue in the proceedings before us.

The FMPA Petitioners' next objection deals with new customer facilities—that is, those built after network service begins under the Tariff. The Commission determined that "the Network customer shall receive a credit where such facilities are jointly planned and installed in coordination with the Transmission Provider." Order 888-A, ¶ 31,048 at 30,534. Petitioners begin by reading this as some sort of "limitation," they expand it into a "condition precedent for customers to receive credit for new facilities," and they end by treating it as a bar to "credits for new customer-facilities unless they are jointly planned," Credits Brief at 43, 44, 45. Commission counsel rightly points out that petitioners have completely misread the rule: "simply put, the Rule does not speak to the situation of new facilities built outside a joint planning effort." Commission Brief at 104. The Commission did determine that a joint planning mandate was "beyond the scope of this proceeding," Order 888-A, ¶ 31,048 at 30,311. Using their mistaken premise, petitioners insist that the Commission acted arbitrarily in this regard, giving transmission providers the power to block all customer credits for new facilities. See Credits Brief at 45. Since their presence is mistaken, their conclusion must be rejected. The balance of [Page 90]the FMPA petitioners' arguments have been considered and rejected.

VII. LIABILITY, INTERFACE ALLOCATION, AND DISCOUNTING

As part of Order 888, FERC adopted a pro forma Open Access Transmission Tariff (OATT), containing minimum terms and conditions for non-discriminatory service, which every transmission-owning public utility must file with the Commission and by which it must abide in providing transmission services to itself and others. Various petitioners have challenged isolated provisions of the OATT—specifically the provisions governing liability and indemnification, interface allocation, and delivery point specific discounting. We reject each of these challenges.

A. Liability and Indemnification

Prior to unbundling, retail tariffs were primarily a matter for state regulation, and most states had approved tariff provisions permitting utilities to limit their liability for service interruptions to instances of gross negligence or willful misconduct. Courts upheld these limitations on the public policy grounds that they balanced lower rates for all customers against, the burden of limited recovery for some, and that the technological complicity of modern utility systems and resulting potential for service failures unrelated to human error justified liability limitations. In the past, FERC also has allowed electric utility tariffs to explicitly limit a utility's liability for service interruptions to instances of gross negligence or willful misconduct.

One of the pro forma tariffs included in the Notice of Proposed Rulemaking contained a provision explicitly limiting the liability of transmission providers to circumstances of gross negligence or intentional wrongdoing. See Open Access NOPR, ¶ 32,514 at App. C § 15.0. Section 10.2 of the OATT requires the transmission customer to "at all times indemnify, defend, and save the Transmission Provider harmless from any and all damages ... except in cases of negligence or intentional wrongdoing by the

Transmission Provider." Order 888, ¶ 31,036 at 31,936-37 (emphasis added). In Order [Page 91]888, FERC justified the change with a single statement: "We find that this new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases, where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765.

The investor owned utility petitioners (IOUs) challenge the OATT's indemnification provision on the ground that FERC adopted the lesser ordinary negligence standard in Order 888 without first notifying interested parties that it was contemplating such a major policy change. The IOUs claim that the change in the provision's language represents a significant shift in indemnification policy, in that it leaves transmission providers open to claims of ordinary negligence for the first time. The courts consistently have relied upon explicit tariff provisions to enforce the gross negligence standard for liability, see, e.g., Southwestern Bell Tel. Co. v. Rucker, 537 S.W.2d 326, 330-32, 334 (Tex. App. 1976); and if the tariffs do not explicitly limit liability for ordinary negligence, the IOUs claim, the courts will assess such matters differently. Because FERC's notice was not clear that the liability standard was a subject or issue of the rulemaking, the IOUs claim that FERC denied their right to comment on the change. See, e.g., AFL-CIO v. Donovan, 757 F.2d 330 (D.C. Cir. 1985); McLouth Steel Prods. Corp. v. Thomas, 838 F.2d 1317 (D.C. Cir. 1988). Citing principally our opinion in Air Transport Association of America v. DOT, 900 F.2d 369, 379 (D.C. Cir. 1990), the IOUs contend that the fact that they were able to raise their concerns in their petition for rehearing is not a substitute for pre-issuance notice and comment.[17]

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[17] We recognize that Air Transport has been vacated. See Air Transport Association of America v. DOT, 933 F.2d 1043 (1991) (per curiam).

FERC responds by denying that the indemnification provision adopts a particular liability standard at all. FERC claims that it has merely distinguished liability from indemnification, and that the change to the pro forma tariff does not establish a new, simple negligence standard of liability for transmission providers. Citing its own statements in Order [Page 92]888-A, FERC asserts that the tariffs indemnification provision should not be construed as preempting state liability standards. See Order 888-B, ¶ 61,248 at 62,080-81. FERC maintains that, since the change to the indemnification provision does not represent a substantive alteration in policy or the standards governing legal liability, the Commission was not obligated to notify interested parties and seek comment. FERC accuses the petitioners of wanting FERC to impose a federal gross negligence liability standard, which FERC contends that it properly declined to do pursuant to United Gas Pipe Line Co. v. FERC, 824 F.2d 417 (5th Cir. 1987) (rejecting the need for a federal liability standard for pipelines).

The IOUs charged that FERC has deleted a limitation of liability to gross negligence from the existing background of utilities liability law and has done so without substantial evidence and without exercising reasoned decision making. See Mid-Tex Elec. Coop., Inc. v. FERC, 773 F. 2d 327, 338 (D.C. Cir. 1985) (the Commission's decision must be supported by substantial evidence and be the result of reasoned decision making). The Commission denies that it has established a standard of liability nearly so sweeping as the IOUs fear. We agree with FERC's reading of the rule. While the petitioners argue that the rule works a "dramatic change" regarding the liability of electric utilities by imposing an ordinary negligence rather than a gross negligence standard that previously prevailed, in fact, the rule does not establish a new simple negligence standard of liability for transmission providers. While we read FERC's interpretation of its own rule deferentially see—Jersey Shore Broad. Corp. v. FERC, 37 F.3d 1531, 1536 (D.C. Cir. 1994),

by any standard, its construction is correct in the present controversy and the preamble to the regulations before us, FERC plainly describes the disputed provision as an "indemnification" provision, and recites reasoning supporting the particular indemnification provision it adopted. "[T]his new indemnification provision would be too strict if it required customers to indemnify transmission providers even in cases where the transmission provider is negligent." Order 888, ¶ 31,036 at 31,765. [Page 93]In the preamble to Order 888-A, in a section concededly headed "*Liability* and Indemnification" (emphasis added), FERC explains the later version of the relevant provisions in terms consistent with the Order 888 preamble. See generally Order 888-A, ¶ 31,048 at 30,299-302. Finally, in Order 888-B, FERC summarizes its reasoning for its indemnification and liability decisions, again both adequately and in ways not amounting to the adoption of the universal standard as asserted by the IOUs. See generally Order 888-B, ¶ 61,248 at 62,079-81. In short, FERC's rule does not work so sweeping a change in the legal landscape as the IOUs assert, and FERC has exercised reasoned decisionmaking in support of such pronouncements as it has made.

Insofar as the IOUs challenge the adequacy of FERC's notice in the NOPR that it was contemplating a change in the indemnification and liability provisions of pro forma tariffs, that challenge also fails. It is well established that a final rule need not be identical to the original proposed rule. See, e.g., AFL-CIO v. Donovan, 757 F.2d at 338; Trans-Pacific Freight Conference v. Federal Maritime Comm'n, 650 F.2d 1235, 1249 (D.C. Cir. 1980). Were the change between the proposed and final rule an important one, we would have to ask whether the final rule is a logical outgrowth of the proposed one. See, e.g., National Mining Ass'n v. Mine Safety & Health Admin., 116 F.3d 520, 531 (D.C. Cir. 1997). Not all changes are sufficiently important to warrant such scrutiny and concern, however. "An agency, after all, must be free to adopt a final rule not described exactly in the

[notice of proposed rulemaking] where the difference is sufficiently minor, or agencies could not change a rule in response to valid comments without beginning the rulemaking anew." National Cable Television Ass'n v. FCC, 747 F.2d 1503, 1507 (D.C. Cir. 1984).

We agree with FERC that its indemnification provision does not preclude the states from shielding utilities from liability for ordinary negligence. States did so before, through both their regulatory commissions and their courts; and they remain free to do so under Order 888. The deletion of the gross negligence language from the pro forma tariffs indemnification provision does not significantly change the [Page 94]petitioners' legal position. Therefore, contrary to the IOUs challenge, the deviation of the final rule from the proposed one is not a major one; and FERC's failure to notify interested parties that it was, considering the change does not render the provision arbitrary or capricious under the APA. Accordingly, we affirm this portion of the pro forma tariff.

B. Interface Allocation

The IOUs also challenge FERC's treatment of interface allocation as unsupported by the record and contrary to reasoned decision making. Section 30.8 of the pro forma tariff addresses how much of a transmission provider's interface capacity a network customer can use. See Order 888, ¶ 31,036 at 31,954-55. Interface capacity represents the capability of a transmission facility to transfer power between two utilities. Section 30.8 permits a network customer to use a transmission provides capacity to the extent of the network customer's total load without limitation.

In the rulemaking process, several parties argued that a fair method of interface allocation would be the use of a load ratio, under which the transmission provider and each network customer would be allocated a share of each specific

interface based upon their respective loads. Nevertheless, in Order 888, FERC ruled that network customers could use any of the transmission providers' interfaces to import up to their full load on a first-come, first-served basis. The IOUs maintain that this ruling does not promote an equitable allocation of a transmission provider's interfaces.

The IOUs also note that, responding to the IOUs petition for rehearing on this issue in Order 888-A, FERC merely referenced Florida Municipal Power Agency v. Florida Power & Light Co., 74 F.E.R.C. ¶ 61,006 (1996) (hereinafter FMPA II), to support its conclusion, without addressing either the comments or the rehearing petitions. FERC meanwhile maintains it found the load ratio share method advocated by some transmission owners to be unreasonable for the same reasons discussed at length in FMPA II Intervenors add that the IOUs' challenge of the aggregate, [Page 95]first-come, first-served approach adopted by FERC as inequitable merely reflects a disagreement with FERC's policy choice.

Whether to adopt a load ratio share approach. or an aggregate, first-come, first-served approach to capacity allocation is a matter of policy. Again, the IOUs have not challenged FERC's legal authority to select a particular interface allocation method, but rather whether FERCs choice was based upon reasoned decision making. Accordingly, we evaluate FERC's treatment of interface capacity allocation under the APA's arbitrary and capricious standard. See 5 U.S.C. § 706(2)(A) (1994).

FERC's analysis of the issue in the present rulemaking consists solely of a reference to and quotation from its earlier in FMPA II. See Order 888-A, ¶ 31,048 at 30,304-05. That proceeding involved an application by Florida Municipal Power Agency for open access to Florida Power & Light Company's transmission facilities pursuant to FPA §§ 211 and 212. See FMPA II, 74 F.E.R.C. ¶ 61,006 at 61,004; see also Florida Mun. Power Agency v. Florida Power & Light

Co., 67 F.E.R.C. ¶ 61,167 (1994) (hereinafter FMPA I). In FMPA I and FMPA II, FERC justified its choice of policies as follows:

> [T]here are no restrictions on the use of other parts of the transmission system. If the interfaces are constrained, Florida Power and FMPA should simply redispatch and share the redispatch costs and, ultimately, Florida Power will build new facilities when needed. The interfaces, are just another part of the transmission grid, and Florida Power must plan and operate the grid, including, the interfaces, to meet the combined needs of Florida Power and FMPA on an equal basis. When there are conflicting needs to use the same interface capacity, the parties have already agreed that the combined Florida Power and FMPA systems will be redispatched and the costs shared. When the grid, including interfaces, needs to be expanded, Florida Power will undertake the expansion on behalf of the combined system.

[Page 96] FMPA II 74 F.E.R.C. ¶ 61,006 at 61,018 (quoting FMPA I, 67 F.E.RC. ¶ 61,167 and 61,484. While FERC's recognition of the petitioner's concerns was certainly cursory, and its language in FMPA II is slightly oblique, FERC has adequately demonstrated that it gave full consideration before rejecting load ratio share in favor of aggregate, first-come, first-served capacity allocation. Accordingly, we uphold FERCs ruling on the interface capacity allocation issue.

C. Different Point-Specific Discounting

Two groups of transmission dependent utilities, TAPS and TDU Systems, and the nation's largest power wholesaler, Enron Power Marketing (collectively the U&D petitioners), challenge FERC's decision to permit delivery-point-specific discounting. Electric utilities often offer both firm and non-

firm service. Firm service permits customers to demand transmission at any time, while non-firm service permits the utility to cut service when there is not enough excess capacity.

In Order 888, FERC allowed transmission providers to offer discounted rates for non-firm service only if they gave the same discounted rate to all customers for the same transmission path and on all other unconstrained transmission paths. See Order 888, ¶ 31,036 at 31,743-44. FERC also required that the discounts be posted in advance so that all customers could have equal opportunity to take advantage of the discounted rate. See id. at 31,744. In Order 888-A, FERC narrowed the requirement, so that a transmission provider offering a discount on a particular path need only provide the same discount to all other unconstrained paths that go to the same delivery point in the provider's system. See Order 888-A, ¶ 31,048 at 30,275-76. FERC also said that a transmission provider should discount only if necessary to increase throughput on its system. See id. at 30,274.

The U&D petitioners contend that delivery-point-specific discounting results in higher transmission rates for transmission dependent utilities (TDUs), who rely on point-to-point service rather than network service for their transmis-[Page 97]sions. Delivery point-specific discounting permits transmission facility owners to select the delivery points for which they will discount firm and non-firm service. The U&D petitioners argue that this discounting method allows transmission facility owners to discriminate by denying discounts to the delivery points used by the TDUs, thereby raising the transmission costs of these competitors, and in turn decreasing competition at both retail and wholesale.

Additionally, because of the subordination and interruptibility of non-firm service, the U&D petitioners claim that FERC's longstanding pricing policies utilized

discounting as the mechanism for ensuring that non-firm service was priced below firm service. The notice of proposed rulemaking emphasized FERC's reliance on non-discriminatory discounting to achieve higher firm service rates than non-firm rates, so that non-firm rates would reflect the interruptibility of transmission services and be economically efficient. The petitioners argue that FERC's decision in Order 888 to deny discounting of non-firm rates unless firm rates are also discounted an unexplained reversal of that longstanding pricing policy. By adopting a deliver-point-specific discounting rule, the petitioners claim that FERC subjects TDUs to firm rates for all non-firm service. As a result, the petitioners contend, the price that TDUs have to pay for non firm service does not reflect the interruptibility of that service. The petitioners maintain that this aspect of FERC's order itself represents undue discrimination, and that FERC failed to explain why it rejected a compromise position which would restrict opportunities for discrimination and address concerns that the new rules discourage discounting.

FERC notes that it discussed the discounting issue in Orders No. 888, 888-A, and 888-B. See Order 888, ¶ 31,036 at 31,743-44; Order 888-A, ¶ 31,048 at 30,272-76; Order 888-B, ¶ 61,248 at 62,072-75. FERC accuses the petitioners of wanting the Commission to require transmission providers to discount all non-firm services below firm rates regardless of the facts of the particular case. FERC asserts that it did not seek to discourage discounting, but was concerned that if it required discounting on all unconstrained paths as a condition [Page 98]for offering discounts, transmission providers would be discouraged from offering any discounts at all. Fewer discounts could lead to decreased use of transmission services, and therefore a decline in overall transmission revenues, and a corresponding increase in transmission rates to enable transmission providers to recover their costs. FERC maintains that the petitioners, like everyone else, retain the opportunity to compete with the

transmission provider for power sales to the same delivery point at the same discounted rate. FERC argues that its orders are consistent with its established pricing policy of permitting flexibility to reflect interruptibility and efficient use of the transmission system, subject to the firm price cap. In most case, FERC expects that non-firm transmission rates will be priced below the firm rate.

Although the petitioners hint at a statutory claim by alleging that FERC's orders result in undue discrimination and higher rates in violation of the FPA's statutory mandate, the petitioners generally confine themselves to arguing that FERC's decisions to permit delivery-point-specific discounting and non-firm rates equal to firm rates represent unexplained departures from established policy. We therefore analyze this issue under the arbitrary and capricious standard of the APA. See 5 U.S.C. § 706(2)(A).

With respect to non-firm versus firm rates, the cases cited by the petitioners as demonstrating a previously established discounting policy actually establish that FERC addresses this issue on a case-by-case basis. For example, in Kentucky Utilities Co., 15 F.E.R.C. ¶ 61,002 (1981), FERC said that the utility could not allocate capacity costs to non-firm transmission service since such service did not factor into the utility's capacity decisions. In contrast, in Central Maine Power Co., 60 F.E.R.C. ¶ 61,285 (1992), while FERC noted that non-firm service generally warrants a rate lower than firm service, FERC also upheld the utility's decision not to offer non-firm rate discounts on several contracts. Indeed, the petitioners acknowledge that FERC's pre-Order 888 Transmission Pricing Policy Statement, 59 Fed. Reg. 55,031 (1994), does not [Page 99]expressly require non firm rates to be priced below firm rates in all cases. See Br. of U&D Petitioners at 2400.

The petitioners cite American Electric Power Service Corp., 82 F.E.R.C. ¶ 61,090 (1998), for the proposition that, after adopting delivery-point-specific discounting, FERC has

refused to consider whether non-firm rates should be lower than firm rates; but in that case, FERC did consider that issue found the rates in question to be nondiscriminatory, and refused only to consider the petitioners generic challenges to its broader policy of flexibility. Additionally, the petitioners charge that FERC's acceptance of firm rates for non-firm service conflicts with this court's decision in Fort Pierce Utilities Authority v. FERC, 730 F.2d 778, 788-89 (D.C. Cir. 1984); but in that case, this court merely noted that FERC had failed to reconcile its decision to allocate capacity costs to non-firm transmission service with its previous refusal to do so in Kentucky Utilities, and remanded for further consideration. In short, FERC does not appear to have changed its overall pricing policy at all, except to fine tune its guidance as to when discounting might be considered discriminatory.

Which brings us to whether delivery-point-specific, discounting in fact discriminates against the TDUs. Essentially, FERC and the petitioners offer conflicting discounting theories, both of which seem plausible. In its request for rehearing, TAPS observed that, by allowing transmission providers to select which delivery points merit discounts, FERC permits the providers to select for discounting those delivery points which serve their affiliates, and not to select the similarly situated delivery points which serve the TDUs. On rehearing, FERC quite logically maintained that requiring transmission providers to apply discounts to all unconstrained transmission paths could discourage discounting generally, resulting in higher rates for all. See Order 888-A, ¶ 31,048 at 30,275. FERC subsequently asserted that requiring transmission providers to offer the same discount for the same time period on all unconstrained paths that go, to the same [Page 100]delivery point will achieve sufficient comparability. See Order 888-B, ¶ 61,248 at 62,075. FERC noted that it will be able to monitor the discounting behavior of transmission providers for discrimination through the data posted on OASIS. See id.

The record reflects that FERC considered fully all of the arguments, and concluded that delivery-point-specific discounting best accomplished comparability while encouraging discounting. Thus, the discounting policies outlined in Orders 888, 888-A, and 888-B are not arbitrary or capricious. We therefore affirm FERC's resolution of this issue.

VIII. TARIFF TERMS AND CONDITIONS

A. Headroom Allocation

Firm point-to-point service, as distinguished from network service, is transmission service reserved and/or scheduled between specified points of receipt and delivery. See Order 888-A, ¶ 31,048 at 30,508. Point-to-point customers may not need all the service for which they contracted. The Commission decided that they may, without extra charge, use their excess capacity to make firm sales between the receipt and delivery points specified in their agreement. Section 22.1 of the Tariff gives them another option for dealing with this "headroom. "The point-to-point customer may, without charge, have the public utility provide transmission on a non-firm basis over receipt and delivery points other than those "specified in the service agreement (so-called "secondary" points).

Network customers describing themselves as Transmission Dependent Utilities (TDUs) contend that the flexibility given to point-to-point customers to sell their unused capacity should also be given to them. Three transmission providers[18]—the CPL petitioners-want restrictions placed on point-to-[Page 101]point customers in order to avoid Putting the customers at a competitive advantage. The Commission refused to adopt there proposals for reasons we believe are sound.

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[18] Carolina Power & Light Company (CPL), Florida Power & Light Company and Niagara Mohawk Power Corporation.

As to transmission providers, the Commission noted that if they want to make off-system sales they too must take point-to-point service; in doing so they gain the same flexibility as regular point-to-point customers. See Order 888, ¶ 31,036 at 31,751. For network customers, the Commission stated that they "are not obligated to take network transmission service" and if they wait to take advantage of the as-available, non-firm service over secondary points of receipt and delivery through the point-to-point service, they may elect to take firm point-to-point transmission service in lieu of the network service." Order 888-A, ¶ 31,048 at 30,253. The Commission properly insisted on maintaining its basic distinctions between network service and point-to-point service. Unlike a point-to-point customer, a network customers rights are defined in terms of capacity needed and thus "vary as the customer's load varies," rendering them not sufficiently definite and defined to be "reassignable in the secondary market." Id. at 30,223. At least one of the TDUs agreed with the Commission "that, because there is no fixed capacity reservation for network customers, allowing them unrestricted use of capacity to make off-system sales without additional charge would give such customers a competitive advantage over [point-to-point] customers." Terms and Conditions Brief at 11.[19]

B. Headroom Prioritization

Some petitioners complain that secondary non-finn point-to-point customers should not have been placed in a status below non-firm point-to-point customers and that the

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19 These petitioners add that the Vermont Department of Public Service (VDPS) offered a solution to the problem but the Commission overlooked it. Terms and Conditions Brief at 12. This is not correct. The Commission did consider the Vermont proposal, finding it to be an "artifice derived from the load ratio share calculation," a "formula [that] does not result in a reassignable capacity right." Order 888-A, ¶ 31,048 at 30,223.

Com-[Page 102]mission offered no explanation for its doing so. See Terms and Conditions Brief at, 14-17. The Commission did explain itself. Firm point-to-point customers are permitted to designate secondary receipt and delivery points at no extra charge and therefore "are properly accorded a lower priority than stand alone, non-firm transmission." Order 888-A, ¶ 31,048 at 30,281. Furthermore, the Commission promised to reevaluate its approach in response to any "future transmission rate proposal that is based on the concept of tradable capacity rights," but it was moving cautiously because in the electric utility industry (unlike the natural gas industry) such "trading rights simply do not exist at this time." Id.

C. Duplicative Charges

The TDU petitioners argue that the new rules cause them to be double-charged in certain transactions. They first object to the Commission's decision that in power exchanges (flows in one direction for a time and then flows in the opposite direction) each party must reserve and pay for transmission along the same path. See Terms and Conditions Brief at 18. The Commission's response was that traditionally and "from the transmitting utility's planning and reservation perspective," the power exchange consists of two, one-way transmission services. Commission Brief at 115. Petitioners offer no legal basis for us to prefer their treatment to that of the agency and so we will not disturb the Commission's approach.

Petitioners' second objection is that the Tariff double counts network load served by two- separate energy suppliers because, "[i]f two separate suppliers purchase network service to supply a portion of the load for a particular customer, the entire load of the customer is included in calculating the reservation charges paid by both supplying network customers, unless each load portion is isolated electrically from the other." Terms and Conditions Brief at 21. We confess to some difficulty in comprehending

petitioners' complaint. It seems perfectly reasonable to answer, as the Commissions counsel does, that "there is no rational basis- for both the network transmission customer and its power marketer sup-[Page 103]plier to designate the same load under the Tariff." Commission Brief at 115. The power supplier itself may, the Commission pointed out purchase network service; we cannot see why both the power supplier and the power buyer would purchase such service when a purchase by either would suffice. Petitioners seem to concede that in some instances the double-counting problem could be avoided in this manner, yet they think that in some other, ill-defined circumstance it could not. This rulemaking set forth the standard tariff terms. If Petitioners, or any one of them, have some unique circumstances warranting an adjustment, there will be time enough for them to seek relief from the Commission.

D. Multiple Control Areas

Network customers may wish to serve loads in two or more control areas. Some commenters were concerned that such customers would have to pay a network transmission rate to two or more transmission providers based on the customers total load. See supra Section VI (credits for customers). The Commission had several responses. First, the risk could be avoided or alleviated by the customer's purchasing point-to-point service, or a combination of network and point-to-point service at discrete delivery points (thereby reducing its load ratio). Or the customer could purchase network service alone in each transmission provider's control area. See Order 888-B, ¶ 61,248 at 62,096 n.157. If the customer insists on foregoing the last option, it can hardly expect that the additional service it is demanding—the moving of power from one transmission provider's system to another system—should be free of charge. As the Commission put it:

> Because the additional transmission service to non-designated network load outside of the transmission

> provider's control area is a service for which the transmission provider must separately plan and operate its system beyond what is required to provide service to the customer's designated network load [within the control area], it is appropriate to have an additional charge associated with the additional [point-to-point] service.

[Page 104] Order 888-A, ¶ 31,048 at 30,255, quoted in Order 888-B, 81 F.E.R.C. ¶ 61,248 at 62,096. This is consistent with the handling of an analogous situation involving separate transmission systems in the past. See Fort Pierce Utils. Auth. v. FERC, 730 F.2d 778, 781-85 (D.C. Cir. 1984).[20]

E. Right-of-First-Refusal

In order to preserve the certainty and continuity of transmission service the Commission granted existing customers a right-of-first-refusal (ROFR) upon the expiration of contracts exceeding one year provided that the existing customer agreed to match the contract price and term of any party, competing for that service. See Order 888, ¶ 31,036 at 31,665. The Commission did not set an upper limit on the terms that a competing party could offer, but chose instead to allow the market to determine rates and terms. Petitioners argue that the Commission's failure to establish an upper limit should be set aside and remanded for further consideration. The Commission conceded error on this point at oral argument in light of United Gas Distribution Cos. v. FERC, 88 F.3d 1105, 1138-40 (D.C. Cir. 1996). We

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[20] Petitioners claim that the Commission failed to consider a particular proposal related to this subject. See Terms and Conditions Brief at 33. It is unnecessary to describe the- proposal. All that need be said is that the Commission rejected a nearly identical proposal and gave its reasons for doing so. See Order 888-B, ¶ 61,248 at 62,096.

therefore remand this matter to the Commission so that it may provide a reasonable cap on contract extensions.[21]

[Page 105]IX. NATIONAL ENVIRONMENTAL POLICY ACT AND REGULATORY FLEXIBILITY ACT COMPLIANCE

A. NEPA Compliance

One investor-owned utility, Public Service Electric & Gas Company ("PSE&G"), claims that FERC failed to comply with the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 et seq. It argues first that the base case FERC adopted to evaluate the effects of open, access transmission was unreasonable because it "defined away" the effects of open access. Second, it argues, FERC acted arbitrarily and capriciously by failing to undertake measures to mitigate the environmental impact of Order 888.

1. Adequacy of Base Case

NEPA requires federal agencies contemplating a major action "significantly affecting the quality of the human environment" to prepare a thorough analysis of the action's environmental impact. 42 U.S.C. § 4332(C). The statute requires that environmental impact studies include "a detailed statement [of] alternatives to the proposed action." Id. § 4332(C)(iii).

In its environmental impact study prepared in connection with Order 888, FERC identified as the base case alternative a scenario that "maintains] the status quo." FERC Final Environmental Impact Statement, Promoting Wholesale

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[21] The TDU ¡ etitioners stated in their reply brief that Commission counsel's explanation of § 13.2 of the Tariff, as amended in Order No. 888-A and as interpreted in Madison Gas & Electric Co., 82 F.E.R.C. ¶ 61,099 at 61,372 (1998), to, apply only to short term customers satisfies their objection. See Terms and Conditions Reply Brief at 25. The remaining arguments of these petitioners not discussed in this part or in part V have been considered and rejected.

Competition through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of stranded Costs by Public Utilities and Transmitting Utilities at 2-1 (Apr. 1996) ("FEIS") Under that scenario, FERC would continue on a case-by-case basis to (1) condition approval of mergers and applications for sales at market rates on the filing of open access tariffs and (2) approve open access wheeling orders under section 211 of the FPA. Id.

Several commenters (including EPA) argued that FERC should adopt as its base case an alternative that freezes the status quo, i.e., assumes that no further open access transmission of any kind occurs and that efficiency in the industry remains unchanged. See id. at 6-1. Characterizing this [Page 106] "frozen efficiency" case as unreasonable, FERC declined to adopt it as the base case. See id. at 6-9-6-14. It nevertheless conducted sensitivity analyses comparing emissions under the frozen efficiency case with those under its base case. This comparison revealed "modest" reductions in emissions under the frozen efficiency case in certain circumstances. Id. at 6-4. When market conditions favor coal versus natural gas, NO, emissions under the base case are higher than under the frozen efficiency case by two percent in 2000, three percent in 2005, and five percent in 2010. Id. at 6-15. But when market conditions favor gas, the base case produces more favorable environmental benefits for all three years. Id. at 6-17.

We evaluate agency compliance with NEPA under a rule of reason standard. "[A]s long as the agency's decision is 'fully informed' and well-considered it is entitled to judicial deference and a reviewing court should not substitute its own policy judgment." Natural Resources Defense Council, Inc. v. Hodel, 865 F.2d 288, 294 (D.C. Cir. 1988) (quoting North Slope Borough v. Andrus, 642 F.2d 589, 599 (D.C. Cir. 1980)).

PSE&G argues that FERC, in adopting its base case, "defined away" the impact of open access by comparing the

environmental effects that would result from immediate implementation through Order 888 to those that would result from gradual implementation. Calling FERC's evaluation of the frozen efficiency case "cursory," PSE&G contends that the proper no action base case is not to implement-open access at all.

Given the terms of NEPA and our highly deferential review, we think FERC's FEIS complied with the statute. For one thing, NEPA does not require that a certain alternative be adopted as the base case. Rather, NEPA requires that agencies include in their FEIS analysis of "alternatives to the proposed action." 42 U.S.C. § 4332(c)(iii). Thus there is no merit to the contention that NEPA requires FERC to adopt the frozen efficiency case as the base case. We agree with PSE&G that one of the alternatives NEPA requires FERC to consider is the alternative of no action. [Page 107]But based on our own examination of the FEIS, we think that FERC devoted sufficient attention to evaluating the frozen efficiency case (what PSE&G calls the action alternative) to satisfy NEPAs requirements. In conducting sensitivity analyses to its base case, FERC identified the changes in both NO and CO_2 emissions that the frozen efficiency case would produce. Given that FERC's comparison of the frozen efficiency case to its case yielded little difference, the agency had no reason to conduct further analysis. By rigorously examining the frozen efficiency case even though it believed the case to be unreasonable, FERC ensured that its decision was "fully informed" and "well-considered." Hodel, 865 F.2d at 294.

2. Failure to Adopt Mitigation Measures

PSE&G argues that FERC acted arbitrarily and capriciously by failing to adopt measures to mitigate the expected harmful effects of Order 888. Noting that an agency must environmental effect consider mitigation if the proposed action would result in adverse environmental impacts, FERC considered but ultimately rejected any

mitigation measures. See FEIS § 7. In reaching this conclusion, FERC relied on (1) the fact that any mitigation measures it might undertake are unwarranted in view of Order 888's small impact (especially given that its effects are as likely to be beneficial as harmful) and (2) its lack of expertise in atmospheric chemistry, together with the fact that any impact of open access would be "dwarfed by the far larger existing ozone and NO_x, emission issues" currently being dealt with by EPA under its Clear Air Act authority. FEJS at 7-47-7-48.

The heart of PSE&G's challenge is this: downwind utilities, which are subject to NO_x reduction requirements, will face increased compliance costs due to the purported increase in emission levels resulting from Order 888; by comparison, upwind utilities that generate the pollution but are not subject to NO_x reduction requirements will experience no increased costs. PSE&G insists that FERC remedy this "undue preference" for upwind utilities.

[Page 108]Given that FERC has identified only small increases 'in emissions resulting from open access transmission—indeed, under some circumstances, the Commission predicted small decreases—we think it was entirely reasonable for FERC to decline to adopt mitigation measures to address a problem that it believed might not even develop. Not relying solely on Order 888's relatively insignificant environmental impact, however, FERC comprehensively analyzed proposed mitigation measures, explaining why it declined to require any. In light of this thorough analysis, we think FERC's conclusion that No_x emission increases resulting from Order 888, if any, are best addressed by EPA and the states through a comprehensive emissions control program is hardly arbitrary or capricious. We therefore have no need to resolve the parties' debate about FERC's legal authority to order environmental mitigation.

PSE&G also argues that FERC employed unreasonable assumptions in the FEIS and ignored its own data showing adverse environmental impacts. In our view, these arguments amount to an effort by PSE&G to substitute its own analysis for FERC's. To prevail in this court, it must demonstrate that FERC's analysis is arbitrary and capricious, a showing it has fallen far short of making.

B. Regulatory Flexibility Act Compliance

The Regulatory Flexibility Act requires agencies to conduct a regulatory flexibility analysis for any final rule. The Act exempts agencies from this requirement if they certify that "the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(a)-(b). Invoking this exemption, FERC certified that both Order 888 (open access) and Order 889 (OASIS and standard of conduct rules) would have no such impact. Order 888, ¶ 31,036 at 31,896; Order 889, ¶ 31,035 at 31,628.

The TDU petitioners claim that FERC failed adequately to consider the impact of Orders 888 and 889 on nonjurisdictional entities that may have to provide open access transmission and file open access tariffs under the orders reciprocity provisions. In contrast to jurisdictional utilities, several non-[Page 109]jurisdictional utilities are classified as small entities. According to TDU petitioners, the orders impose a significant economic burden on them, requiring compliance activities as well as alterations to their operations.

Although the RFA's judicial review provision was amended in 1996, see Small Business Regulatory Enforcement Fairness Act, Pub. L. No. 104-12 1, tit. II 110 Stat. 857 (1996), the TDU petitioners and FERC agree that the pre-amendment version of the RFA applies in this case. Under that version, our review is quite narrow. Section 611 (b) provided that "[a]ny regulatory flexibility analysis ... and

the compliance or noncompliance of the agency with the provisions of this chapter shall not be subject to judicial review. When an action for judicial review of a rule is instituted, any regulatory flexibility analysis for such rule shall constitute part of the whole record of agency action in connection with the review." 5 U.S.C. § 611(b) (1994). We have interpreted this language to mean that "'a reviewing court should consider the regulatory flexibility analysis as part of its overall judgment whether a rule is reasonable and may, in an appropriate case, strike down a rule because of a defect in the flexibility analysis.' We emphasize[ ], however, that 'a major error in the regulatory flexibility analysis may be, but does not have to be, grounds for overturning a rule.'" Mid-Tex Elec. Co-op, Inc. v. FERC, 773 F.2d 327, 340-41 (D.C. Cir. 1985) (quoting Small Refiner Lead Phase-Down Task Force v. EPA, 705 F.2d 506, 537-39 (D.C. Cir. 1983)).

In this case, FERC explained that Orders 888 and 889, considered in their entirety, do not have a "significant" impact on a "substantial" number of small entities. According to FERC, the orders will affect nonjurisdictional utilities only in the limited situation where they take advantage of a jurisdictional utility's open access transmission tariff. Given our highly deferential standard of review, and given the fact that petitioners have offered nothing other than their own views to the contrary, we have no basis for questioning FERC's judgment.

[Page 110]FERC, moreover, was not insensitive to the potential impact of Order 888 on small nonjurisdictional entities. Order 888 contains a waiver provision allowing these entities to seek an exemption from compliance with the reciprocity conditions. See 18 C.F.R. § 35.28(e)(2) (allowing nonjurisdictional utilities to file a request for waiver "for good cause shown"). As of March 1997, FERC had granted waivers to thirty-six small entities. See Order 888-A, ¶ 31,049 at 30,578.

Most important in view of our standard of review, nothing in petitioners' arguments causes us to question the reasonableness of the reciprocity provisions themselves. See Mid-Tex, 773 F.2d at 340-41. We therefore affirm FERC's RFA certification.

CONCLUSION

In summary, we affirm Orders 888 and 889 in all respects except as specifically provided above.

APPENDIX C

Order of the United States Court of Appeals for the District of Columbia Circuit filed Aug. 22, 2000

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 97-1715 September Term, 1999

Transmission Access Policy Study Group,
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

Vermont Department of Public Service, et al.,
Intervenors

Consolidated with 98-1111, 98-1122, 98-1113, 98-1114, 98-1115, 98-1118, 98-1119, 98-1120, 98-1122, 98-1124, 98-1125, 98-1126, 98-1127, 98-1128, 98-1129, 98-1131, 98-1132, 98-1134, 98-1136, 98-1137, 98-1139, 98-1140, 98-1141, 98-1142, 98-1143, 98-1145, 98-1147, 98-1148, 98-1149, 98-1150, 98-1152, 98-1153, 98-1154, 98-1155, 98-1156, 98-1159, 98-1162, 98-1163, 98-1166, 98-1168, 98-1169, 98-1170, 98-1171, 98-1172, 98-1173, 98-1174, 98-1175, 98-1176, 98-1178, 98-1180

BEFORE: Edwards, Chief Judge; Silberman, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers, Tatel and Garland, Circuit Judges

ORDER

Upon consideration of petitioners' petition for rehearing en banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: s/Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Circuit Judges Silberman and Henderson did not participate in this matter.

Filed On: UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT

Filed: AUG 22 2000
Clerk

APPENDIX D

***Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888, [1991-96 Reg. Preambles] F.E.R.C. Stats. & Regs. ¶ 31,036 (1996) (pertinent portions)**

APPENDIX D

[31,632]

[¶31,036]

61 F.R. 21540 (May 10, 1996)

18 CFR Parts 35 and 385

[Docket Nos. RM95-8-000 and RM94-7-001; Order No. 888]

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities

Issued April 24, 1996

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is issuing a Final Rule requiring all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. The Final Rule also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services. The Commission's goal is to remove impediments to competition in the wholesale bulk power marketplace and to bring

[31,633]

more efficient, lower cost power to the Nation's electricity consumers.

EFFECTIVE DATE: This Final Rule will become effective on July 9, 1996.

FOR FURTHER INFORMATION CONTACT: David D. Withnell (Legal Information--Docket No. RM95-8-000), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-2063

Deborah B. Leahy (Legal Information--Docket No. RM94-7-001), Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-2039

Michael A. Coleman (Technical Information), Office of Electric Power Regulation, Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426, (202) 208-1236.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the Federal Register, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in the Public Reference Room at 888 First Street, NE., Washington, DC 20426.

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may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in the Public Reference Room at 888 First Street NE., Washington, DC 20426.

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Statement of Commissioner Massey

I. Introduction/Summary

Today the Commission issues three final, interrelated rules designed to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the Nation's electricity consumers.[1] The legal and policy cornerstone of these rules is to remedy undue discrimination in access to the monopoly owned transmission wires that control whether and to whom electricity can be transported in interstate commerce. A second critical aspect of the

[31,635]

rules is to address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced.

In the year since the proposed rules were issued,[2] the pace of competitive changes in the electric utility industry

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[1] These rules are the rules on open access and stranded costs in the above dockets (*FERC Statutes and Regulations* ¶31,036), and an accompanying rule on Open Access Same-Time Information System and Standards of Conduct (OASIS Final Rule) (*FERC Statutes and Regulations* ¶31,037) being issued contemporaneously. The Commission also is issuing capacity reservation open access transmission tariffs in Docket No. RM96-11-000, *FERC Statutes and Regulations* ¶32,517. These final rules and proposed rule are being published concurrently in the *Federal Register*.

[2] On March 29, 1995, the Commission issued two notices of proposed rulemaking concerning open access transmission and stranded cost recovery. Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, 60 FR 17662 (April 7, 1995), *FERC Statutes and Regulations* ¶32,514 (1995). On December 13, 1995, the Commission issued a notice of proposed rulemaking on information systems. Real-Time Information Networks and Standards of Conduct, Notice of

has accelerated. By March of last year, 38 public utilities had filed wholesale open access transmission tariffs with the Commission. Today, prodded by such competitive changes and encouraged by our proposed rules, 106 of the approximately 166 public utilities that own, control, or operate[3] transmission facilities used in interstate commerce have filed some form of wholesale open access tariff. In addition, since the time the proposed rules were issued, numerous state regulatory commissions have adopted or are actively evaluating retail customer choice programs or other utility restructuring alternatives. These events have been spurred by continuing pressures in the marketplace for changes in the way electricity is bought, sold, and transported. Increasingly, customers are demanding the benefits of competition in the growing electricity commodity market.

The Commission estimates the potential quantitative benefits from the Final Rule will be approximately $3.8 to $5.4 billion per year of cost savings, in addition to the non-quantifiable benefits that include better use of existing assets and institutions, new market mechanisms, technical innovation, and less rate distortion. The continuing competitive changes in the industry and the prospect of these benefits to customers make it imperative that this Commission take the necessary steps within its jurisdiction to ensure that all wholesale buyers and sellers of electric energy can obtain non-discriminatory transmission access, that the

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Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516 (1995).

[3] The Commission's notice of proposed rulemaking in the above dockets proposed to apply the proposed requirements to public utilities that own and/or control facilities used for the transmission of electric energy in interstate commerce. "Own and/or control" is intended to include public utilities that "operate" facilities used for the transmission of electric energy in interstate commerce. However, we have modified the Final Rule regulatory text to remove any ambiguity.

transition to competition is orderly and fair, and that the integrity and reliability of our electricity infrastructure is maintained.

In this Rule, the Commission seeks to remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access. Indeed, it is our statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination.

To do so, we must eliminate the remaining patchwork of closed and open jurisdictional transmission systems and ensure that all these systems, including those that already provide some form of open access, cannot use monopoly power over transmission to unduly discriminate against others. If we do not take this step now, the result will be benefits to some customers at the expense of others. We have learned from our experience in the natural gas area the importance of addressing competitive transition issues early and with as much certainty to market participants as possible.

Accordingly, in this proceeding and in the accompanying proceeding on OASIS, the Commission, pursuant to its authorities under sections 205 and 206 of the FPA:

- Requires all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce

- To file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service;

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- To take transmission service (including ancillary services) for their own new wholesale sales and purchases of electric energy under the open access tariffs;

- To develop and maintain a same-time information system that will give existing and potential transmission users the same access to transmission information that the public utility enjoys, and further requires public utilities to separate transmission from generation marketing functions and communications;

- Clarifies Federal/state jurisdiction over transmission in interstate commerce and local distribution and provides for deference to certain state recommendations; and

- Permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and FPA section 211 transmission services.

Open Access

The Final Rule requires public utilities to file a single open access tariff that offers both network, load-based service and point-to-point, contract-based service. The Rule contains a pro forma tariff that reflects modifications to the NOPR's proposed terms and conditions and also permits variations for regional practices. All public utilities subject to the Rule, including those that already have tariffs on file, will be required to make section 206 compliance filings to meet the new pro forma tariff non-price minimum terms and conditions of non-discriminatory transmission. Utilities may propose their own rates in a section 205 compliance filing.

The Rule provides that public utilities may seek a waiver of some or all of the requirements of the Final Rule. In addition, non-public utilities may seek a waiver of the tariff reciprocity provisions.

The Final Rule does not generically abrogate existing requirements contracts, but will permit customers and public utilities to seek modification, or termination, of certain existing requirements contracts on a case-by-case basis. As to coordination arrangements and contracts, the Rule finds that

these arrangements and contracts may need to be modified to remove unduly discriminatory transmission access and/or pricing provisions. Such arrangements and agreements include power pool agreements, public utility holding company agreements, and certain bilateral coordination agreements. The Rule provides guidance and timelines for modifying unduly discriminatory coordination arrangements and contracts, and specifies when the members of such arrangements must begin to conduct trade with each other using the same open access tariff offered to others. The Rule also provides guidance regarding the formation of independent system operators (ISOs).

The Rule does not require any form of corporate restructuring, but will accommodate voluntary restructuring that is consistent with the Rule's open access and comparability policies.

As discussed in the NOPR, not all owners or controllers of interstate transmission facilities are subject to the Commission's jurisdiction under sections 205 and 206 of the FPA and therefore are not subject to this Rule's open access requirements. Therefore, the Final Rule retains the proposed reciprocity provision in the pro forma tariff. Without such a provision, non-open access utilities could take advantage of the competitive opportunities of open access, while at the same time offering inferior access, or no access at all, over their own facilities. Thus, open access utilities would be unfairly burdened. We note that some non-jurisdictional utilities have expressed an interest in a mechanism for obtaining a Commission determination that their transmission tariffs satisfy the reciprocity provisions in the pro forma tariffs, and we provide such a mechanism in the Rule.

The Final Rule does not generically provide for market-based generation rates. Although the Rule codifies the Commission's prior decision that there is no generation dominance in new generating capacity, intervenors in cases

may raise generation dominance issues related to new capacity. In addition, to obtain market-based rates for existing generation, we will continue to require public utilities to show, on a case-by-case basis, that there is no generation dominance in existing capacity. Further, in all market-based rate cases, we will continue to look at whether an applicant and its affiliates could erect other barriers to entry and

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whether there may be problems due to affiliate abuse or reciprocal dealing.

Finally, contemporaneously with this Rule the Commission issues an NOPR on capacity reservation tariffs as an alternative, and perhaps superior, means of remedying undue discrimination.

Transmission/Local Distribution

The Rule clarifies the Commission's interpretation of the Federal/state jurisdictional boundaries over transmission and local distribution. While we reaffirm our conclusion that this Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, we nevertheless recognize the very legitimate concerns of state regulatory authorities as they contemplate direct retail access or other state restructuring programs. Accordingly, we specify circumstances under which we will give deference to state recommendations. Although jurisdictional boundaries may shift as a result of restructuring programs in wholesale and retail markets, we do not believe this will change fundamental state regulatory authorities, including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories. We intend to be respectful of state objectives so long as they do not balkanize interstate

transmission of power or conflict with our interstate open access policies.

Stranded Costs

With regard to stranded costs, the Final Rule adopts the Commission's supplemental proposal. It will permit utilities to seek extra-contractual recovery of stranded costs associated with a limited set of existing (executed on or before July 11, 1994) wholesale requirements contracts and provides that the Commission will be the primary forum for utilities to seek recovery of stranded costs associated with retail-turned-wholesale transmission customers. It also will allow utilities to seek recovery of stranded costs caused by retail wheeling only in circumstances in which the state regulatory authority does not have authority to address retail stranded costs at the time the retail wheeling is required. The Rule retains the revenues lost approach for calculating stranded costs and provides a formula for calculating such costs.

Environmental Issues

The Commission has prepared a Final Environmental Impact Statement (FEIS) evaluating the possible environmental consequences of changes in the bulk power marketplace expected to occur as a result of the open access requirements of this Final Rule. The FEIS focuses, as do most commenters, on possible increases in emissions of nitrogen oxides (NO/X/) from certain fossil-fuel fired generators, which could affect air quality in the producing region and in areas to which these emissions may be carried.

In response to comments on the Draft EIS, the Commission performed numerous additional studies. The FEIS finds that the relative future competitiveness of coal and natural gas generation is the key variable affecting the impact of the Final Rule. If competitive conditions favor natural gas, the Rule is likely to lead to environmental benefits. Both EPA and the Commission staff believe this

projected scenario is the more likely one. If competitive conditions favor coal, the Rule may lead to small negative environmental impacts. However, even using the most extreme, unlikely assumptions about the future of the industry, the negative consequences are not likely to occur until after the turn of the century. Because the impacts will remain modest at least until 2010, there is no need for an interim mitigation program. In addition, even if the data showed more significant negative consequences requiring mitigation, the Commission does not have the statutory authority under the Federal Power Act or the expertise to address this possible far-term problem. The Commission believes, however, that there is time for federal and state air quality authorities to address any potential adverse impact as part of a comprehensive NO_x regulatory program under the Clean Air Act.[4]

Despite our conclusions regarding the lack of environmental impacts expected to result from the Rule, the Commission has examined a wide variety of proposals for mitigating possible adverse effects. We share the view of most commenters

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that the preferred approach for mitigating increased NO_x emissions generally is a NO_x cap and trading regulatory program comparable to that developed by Congress to address sulfur dioxide emissions in the Clean Air Act Amendments of 1990.[5] The Commission has examined various means of establishing such a program, including use of existing federal authorities under the Clean Air Act, cooperative efforts by state and federal air quality regulators, and development of a new emissions regulatory program administered by the Commission under the Federal Power

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4 42 U.S.C. §§7401, *et seq.*

5 42 U.S.C.A. §7651b-e.

Act. The Commission has concluded that a NO_x regulatory program could best be developed and administered under the Clean Air Act, in cooperation with interested states, and offers to lend Commission support to that effort should it become necessary.

Conclusion

The Commission believes that the Final Rule will remedy undue discrimination in transmission services in interstate commerce and provide an orderly and fair transition to competitive bulk power markets.

II. Public Reporting Burden

The Open Access Final Rule and the Stranded Cost Final Rule specify filing requirements to be followed by public utilities that own, control or operate transmission facilities in interstate commerce in making non-discriminatory open access tariff filings and filings to recover legitimate, prudent and verifiable stranded costs. The information collection requirements of the final rules are attributable to FERC-516 "Electric Rate Filings." The current total annual reporting burden for FERC-516 is 828,300 hours.

A. Docket No. RM95-8-000 (Open Access Final Rule)

The Open Access Final Rule requires public utilities filing non-discriminatory open access tariffs to provide certain information to the Commission. The Commission estimated that the public reporting burden for the information collection would average 300 hours per response. This estimate included time for reviewing the requirements of the Commission's regulations, searching existing data sources, gathering and maintaining the necessary data, completing and reviewing the collection of information, and filing the revised information. No comments on the burden estimate were received. Because the Final Rule adopts essentially the same information requirements that are contained in the proposed

rule, we believe that the average filing burden is same for the Final Rule.

In the proposed rule, the Commission noted that there are approximately 328 public utilities, including marketers and wholesale generation entities. We initially estimated that 137 public utilities own, control or operate facilities used for the transmission of electric energy in interstate commerce, and would be subject to the filing requirements of the proposed rule. Upon further review, the Commission believes that approximately 166 public utilities will respond to the information collection. Accordingly, the public reporting burden is estimated to be 49,800 hours.

B. Docket No. RM94-7-001 (Stranded Cost Final Rule)

In the supplemental notice of proposed rulemaking, the Commission estimated that the information requirements of the proposed rule would not differ substantially from those contained in the initial proposed rule. In that notice, the Commission estimated that the public reporting burden for the information requirements contained in the proposed rule would be 50 hours per response with 10 responses annually. No comments on this filing burden were received. The information requirements adopted in the Stranded Cost Final Rule are not substantially different from those in the proposed rule. Therefore, the Commission concludes that there will be no additional public filing burden associated with the Stranded Cost Final Rule.

III. Background

In the NOPR, we set out a detailed statement of the events leading up to this rulemaking. We repeat that background here, updated to reflect what has happened since March 1995, and discuss why it is necessary to undertake regulatory reform in the electric industry at this time. We do so to provide the necessary

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backdrop to our action in adopting this Rule.

A. Structure of the Electric Industry at Enactment of Federal Power Act

The Federal Power Act was enacted in an age of mostly self-sufficient, vertically integrated electric utilities, in which generation, transmission, and distribution facilities were owned by a single entity and sold as part of a bundled service (delivered electric energy) to wholesale and retail customers. Most electric utilities built their own power plants and transmission systems, entered into interconnection and coordination arrangements with neighboring utilities, and entered into long-term contracts to make wholesale requirements sales (bundled sales of generation and transmission) to municipal, cooperative, and other investor-owned utilities (IOUs) connected to each utility's transmission system. Each system covered limited service areas. This structure of separate systems arose naturally due primarily to the cost and technological limitations on the distance over which electricity could be transmitted.

Through much of the 1960s, utilities were able to avoid price increases, but still achieve increased profits, because of substantial increases in scale economies, technological improvements, and only moderate increases in input prices.[6] Thus, there was no pressure on regulatory commissions to use regulation to affect the structure of the industry.[7]

B. Significant Changes in the Electric Industry

In the late 1960s and throughout the 1970s, a number of significant events occurred in the electric industry that changed the perceptions of utilities and began a shift to a

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6 Paul L. Joskow, Inflation and Environmental Concern: Structural Change in the Process of Public Utility Regulation, 17 J. Law & Econ. 291, 312 (1974); *see also* Charles F. Phillips, Jr., *The Regulation of Public Utilities* 11 (1988).

7 *See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at p. 12.

more competitive marketplace for wholesale power.[8] This was the beginning of periods of rapid inflation, higher nominal interest rates, and higher electricity rates.[9] During this time, consumers became concerned about higher electricity rates and questioned any price increases filed by utilities.[10]

During this same time frame, the construction of nuclear and other capital-intensive baseload facilities--actively encouraged by federal and some state governments--contributed to the continuing cost increases and uncertainties in the industry.[11] These investments were made based on the assumptions that there would be steady increases in the demand for electricity and continued large increases in the price of oil.[12] However, due to conservation and economic downturns, the expected demand increases did not materialize. Load growth virtually disappeared in some areas, and many utilities unexpectedly found themselves with excess capacity.[13] In addition, by the 1980s, the oil cartel collapsed, with a resulting glut of low-priced oil.[14] At the same time, inflation substantially increased the costs of these

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8 *See* Joskow, *supra* at p. 312; *see also* Phillips, *supra* at pp. 12-13.

9 *See* Joskow, *supra* at pp. 312-13; *see also* Phillips, *supra* at p. 13. The Arab oil embargo resulted in significantly higher oil prices through the 1970s. *See* Richard J. Pierce, Jr., The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 501 (1984).

10 *See* Joskow, *supra* at p. 313; *see also* Phillips, *supra* at p. 13.

11 *See generally Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168, 1171 (D.C. Cir. 1987).

12 *Id.*

13 *See* Pierce, *supra* at p. 503. By 1983, the Department of Energy had estimated that the sunk costs for canceled nuclear plants alone amounted to $10 billion. *Id.* at p. 498.

14 *Id.*

large baseload generating plants.[15] Surging interest rates further increased the cost of the capital needed to finance and capitalize these projects and completion schedules were significantly

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extended by, in part, more stringent safety and environmental requirements.[16]

As a result, expensive large baseload plants for which there was little or no demand, came onto the market or were in the process of being constructed. Accordingly, between 1970 and 1985, average residential electricity prices more than tripled in nominal terms, and increased by 25% after adjusting for general inflation.[17] Moreover, average electricity prices for industrial customers more than quadrupled in nominal terms over the same period and increased 86% after adjusting for inflation.[18] The rapidly increasing rates for electric power during this period,

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[15] *See* Bernard S. Black & Richard J. Pierce, Jr., The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry, 93 Col. L. Rev. 1339, 1346 (1993) ("Actual costs of nuclear power plants vastly exceeded estimates, sometimes by as much as 1000%.").

[16] *See* Phillips, *supra* at p. 13. Fossil fuel-fired plants became subject to increased regulation as a result of the Clean Air Act of 1970, and its 1977 amendments. 42 U.S.C. §§7401-7642. In 1971, nuclear plant licensing became subject to the environmental impact statement requirements of the National Environmental Policy Act of 1969. 42 U.S.C. §4332. Following the 1979 accident at the Three Mile Island nuclear plant, nuclear plants also became subject to additional safety regulations, resulting in higher costs. *See* Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 35. Between 1976 and 1980, most states and many localities instituted laws governing power plant siting.

[17] Based on retail prices reported in Energy Information Administration (EIA), Monthly Energy Review, January 1995, Table 9.9 (Prices adjusted for inflation using the GDP Deflator (1987 = 100)).

[18] *Id.*

together with the opportunities provided by the Public Utility Regulatory Policies Act of 1978 (PURPA) (discussed *infra*), also prompted some industrial customers to bypass utilities by constructing their own generation facilities. This further exacerbated rate increases for remaining customers--primarily residential and commercial customers.

Consumers responded to these "rate shocks" by exerting pressure on regulatory bodies to investigate the prudence of management decisions to build generating plants, especially when construction resulted in cost overruns, excess capacity, or both. Between 1985 and 1992, writeoffs of nuclear power plants totalled $22.4 billion.[19] These writeoffs significantly reduced the earnings of the affected utilities.[20] Delays in obtaining rate increases to reflect the effects of inflation further reduced investor returns. Thus, many utilities became reluctant to commit capital to long-term construction decisions involving large scale generating plants.[21]

In addition to economic changes in the industry, significant technological changes in both generation and transmission have occurred since 1935. Through the 1960s, bigger was cheaper in the generation sector and the industry was able to capitalize on economies of scale to produce power at lower per-unit costs from larger and larger plants.[22] As a result, large utility companies that could finance and

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19 *See* Black & Pierce, *supra* at p. 1346 (These writeoffs were "about 17% of the book value of total 1992 utility investment.").

20 *Id.*

21 *Id.* ("The high perceived risk of future disallowances reversed utilities' incentives to overinvest, and made utilities extremely reluctant to build new power plants.").

22 *See* Preston Michie, Billing Credits for Conservation, Renewable, and Other Electric Power Resources: an Alternative to Marginal-Cost-Based Power Rates in the Pacific Northwest, 13 Environmental Law 963, 964-65 (1983).

manage construction projects of larger scale had a price advantage over smaller utility companies and customers who might otherwise have considered building their own generating units. Scale economies encouraged power generation by large vertically-integrated utility companies that also transmitted and distributed power. Beginning in the 1970s, however, additional economies of scale in generation were no longer being achieved.[23] A significant factor was that larger generation units were found to need relatively greater maintenance and experience longer downtimes.[24] The electric

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industry faced the situation "where the price of each incremental unit of electric power exceeded the average cost."[25] Bigger was no longer better.

Further dictating against larger generation units were advances in technologies that allowed scale economies to be exploited by smaller size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier. Such new technologies include combined cycle units and conventional steam units that use circulating fluidized bed boilers.[26]

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23 *Id.* at p. 965.

24 Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970- 1991* (March 1993) 37 ("As larger units were constructed, however, utilities discovered that downtime was as much as 5 times greater for units larger than 600 megawatts than for units in the 100-megawatt range.")

25 *Id.; see also* George A. Perrault, Downsizing Generation: Utility Plans for the 1990s, Pub. Util. Fort. 15-16 (Sept. 27, 1990) ("The large base-load generating units that form the backbone of utility systems are almost totally absent from capacity plans for the 1990s.").

26 "From 1982 through 1991, the average capacity of fluidized-bed units increased rapidly to 72 megawatts for 4 units in 1991. The average capacity for the 19 units planned to begin operating in 1992 through 1995

The combined cycle generating plants generally use natural gas as their primary fuel. This technology has been made possible by the development of more efficient gas turbines, shorter construction lead times, lower capital costs, increased reliability, and relatively minimal environmental impacts.[27] Similarly, the circulating fluidized bed combustion boilers, fueled by coal and other conventional fuels, provide a more efficient and less polluting resource.

Today, "the optimum size [of generation plants] has shifted from [more than 500 MW] (10-year lead time) to smaller units (one-year lead time) [in the 50- to 150-MW range]."[28] Indeed, smaller and more efficient gas-fired combined-cycle generation facilities can produce power on the grid at a cost ranging from 5 cents per kWh to less than 3 cents per kWh.[29] This is significantly less than the costs for large plants constructed and installed by utilities over the last decade, which were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.[30]

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increases to 83 megawatts." Energy Information Administration, *The Changing Structure of the Electric Power Industry 1970-1991* (March 1993) 38.

[27] *See* Charles E. Bayless, Less is More: Why Gas Turbines Will Transform Electric Utilities, Pub. Util. Fort. (Dec. 1, 1994) 21.

[28] *Id.* at p. 24. *See also* Wallace E. Brand, Is Bigger Better? Market Power in Bulk Power Supply: From FDR to NOPR, Pub. Util. Fort. (Feb. 15, 1996) 23 at p. 25 (while the optimal baseload unit size is about 500 MW for coal-fired steam turbines, the optimal size for gas fired combined-cycle units is about 150 to 200 MW).

[29] FERC staff calculations based in part on combined-cycle plant cost data reported in 1994 FERC Form No. 1 for a sample of units placed in service during 1990-94. Costs vary with regional fuel and construction costs, among other reasons.

[30] Coal and Nuclear plant cost data reported in 1994 FERC Form No. 1 and the EIA report, *Electric Plant Cost and Power Production Expenses 1991*, 1993 DOE/EIA-0455(91), for plants placed in service during 1986-94; *see also* The 1994 Electric Executives' Forum, Bakke

Significant changes have also occurred in the transmission sector of the industry. Technological advances in transmission have made possible the economic transmission of electric power over long distances at higher voltages.[31] This has made it technically feasible for utilities with lower cost generation sources to reach previously isolated systems where customers had been captive to higher cost generation. In addition, the nature and magnitude of coordination transactions[32] have changed dramatically since enactment of the FPA, allowing increased coordinated operations and reduced reserve margins. Substantial amounts of electricity now move between regions, as well as between utilities in the same region. Physically isolated systems have become a thing of the past.

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C. The Public Utility Regulatory Policies Act and the Growth of Competition

In enacting PURPA,[33] Congress recognized that the rising costs and decreasing efficiencies of utility-owned generating facilities were increasing rates and harming the

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(President and CEO of the AES Corporation), Pub. Util. Fort. (June 1, 1994) 45 ("New generation can be built at about 3 cents per kilowatt-hour (U.S. average). Old generation costs about twice that * * *").

31 *See* Black & Pierce, *supra* at p. 1345 (In the late 1960s and 1970s, improved transmission efficiency and development of regional transmission networks "made it possible to build power plants up to 1000 miles from power users.").

32 Coordination transactions are voluntary sales or exchanges of specialized electricity services that allow buyers to realize cost savings or reliability gains that are not attainable if they rely solely on their own resources. For sellers, these transactions provide opportunities to earn additional revenue, and to lower customer rates, from capacity that is temporarily excess to native load capacity requirements.

33 Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

economy as a whole.[34] To lessen dependence on expensive foreign oil, avoid repetition of the 1977 natural gas shortage, and control consumer costs, Congress sought to encourage electric utilities to conserve oil and natural gas.[35] In particular, Congress sanctioned the development of alternative generation sources designated as "qualifying facilities" (QFs) as a means of reducing the demand for traditional fossil fuels.[36] PURPA required utilities to purchase power from QFs at a price not to exceed the utility's avoided costs and to sell backup power to QFs.[37]

PURPA specifically set forth limitations on who, and what, could qualify as QFs. In addition to technological and size criteria, PURPA set limits on who could own QFs.[38]

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[34] *See generally FERC v. Mississippi*, 456 U.S. 742, 745-46 (1982).

[35] The Power Plant and Industrial Fuel Use Act of 1978. Pub. L. No. 95-617, 92 Stat. 3117 (codified in U.S.C. sections 15, 16, 26, 30, 42, and 43).

[36] QFs include certain cogenerators and small power producers. PURPA also added sections 210, 211, and 212 to the FPA, providing the Commission with authority to approve applications for interconnections and, in limited circumstances, wheeling. However, under section 211, as enacted in PURPA, the Commission could approve an applicati for wheeling only if it found, *inter alia*, that the order "would reasonably preserve existing competitive relationships." Because of this and other limitations in sections 211 and 212 as originally enacted, the provision was virtually ineffective. Only one section 211 order was ever issued pursuant to the original provision, and it was pursuant to a settlement. *See Public Service Company of Oklahoma*, 38 FERC ¶61,050 (1987). As discussed *infra*, section 211 was subsequently revised by the Energy Policy Act of 1992.

[37] 456 U.S. at p. 750. Congress recognized that encouragement was needed in part because utilities had been reluctant to purchase electric power from, and sell power to, nonutility generators. *Id.* at pp. 750-51.

[38] For example, PURPA provided that a cogeneration facility or small power production facility could not be owned by a person primarily engaged in the generation or sale of electric power (other than from

Notwithstanding these limitations, QFs proliferated. In 1989, there were 576 QF facilities. By 1993, there were more than 1,200 such facilities.[39] For the same time period, installed QF capacity increased from 27,429 megawatts to 47,774 megawatts.[40] The rapid expansion and performance of the QF industry demonstrated that traditional, vertically integrated public utilities need not be the only sources of reliable power.

During this period, the profile of generation investment began to change, and a market for non-traditional power supply beyond the purchases required by PURPA began to emerge. QFs were limited to cogenerators and small power producers.[41]

However, other non-traditional power producers who could not meet the QF criteria began to build new capacity to compete in bulk power markets, without such PURPA benefits as the mandatory purchase requirements. These producers, known as independent power producers (IPPs),

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cogeneration or small power production facilities). *See* 16 U.S.C. §§ 796(17) and (18).

39 Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

40 *Id.* EIA data for 1989 through 1991 was for facilities of 5 megawatts or more and for 1992 and 1993 was for facilities of 1 megawatt or more. A comparison with Table 74 on page 121 for the years 1992 and 1993 reveals that this mixing of data bases is likely of minimal effect.

41 Generally, the law has imposed an 80 MW cap on small power producers. A limited exception enacted in 1990 permitted small power facilities that could exceed 80 MW and still qualify as QFs under PURPA. This exception was limited to certain solar, wind, waste, and geothermal small power production facilities and only covered applications for certification of facilities as qualifying small power production facilities that were submitted no later than December 31, 1994 and for which construction commences no later than December 31, 1999. See Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990, Pub. L. No. 101-575, 104 Stat. 2834 (1990), *amended*, Pub. L. No. 102-46, 105 Stat. 249 (1991).

were predominantly single-asset generation companies that did not own any transmission or distribution facilities. While traditional utilities were generally

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reluctant at that time to invest in new generating facilities under cost of service regulation, utilities increasingly became interested in participating in this new generation sector. They organized affiliated power producers (APPs), with assets not included in utility rate base, and sought to sell power in their own service territories and the territories of other utilities. At the same time, power marketers arose. These entities--owning no transmission or generation--buy and sell power.[42]

There were two major impediments to the development of IPPs and APPs. First, the ownership restrictions of the Public Utility Holding Company Act (PUHCA)[43] severely inhibited these new entities from entering the generation business.[44] Second, these entities needed transmission service in order to compete in electricity markets.

While the Commission had no authority to remove PUHCA restrictions,[45] it encouraged the development of IPPs and APPs, as well as emerging power marketers, by authorizing market-based rates for their power sales on a

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[42] The first power marketer in the electric industry was Citizens Energy Corporation. *See Citizens Energy Corporation*, 35 FERC ¶61,198 (1986). Power marketers take title to electric energy. Power brokers, on the other hand, do not take title and are limited to a matchmaking role.

[43] 15 U.S.C. §79 *et seq.*

[44] As discussed *infra*, Congress eventually provided a means to avoid the PUHCA restrictions by creating exempt wholesale generators (EWGs) in the Energy Policy Act.

[45] The industry was successful to some extent in developing ownership structures that permitted such investment. *See, e.g., Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368, at p. 62,240 and n.20 (1990).

case-by-case basis and by encouraging more widely available transmission access. From 1989 through 1993, facilities owned by IPPs and other non-traditional generators (other than QFs) increased from 249 to 634 and their installed capacity increased from 9,216 megawatts to 13,004 megawatts.[46] Indeed, "[i]n 1992, for the first time, generating capacity added by independent producers exceeded capacity added by utilities."[47]

Market-based rates helped to develop competitive bulk power markets. A generating utility allowed to sell its power at market-based rates could move more quickly to take advantage of short-term or even long-term market opportunities than those laboring under traditional cost-of-service tariffs, which entail procedural delays in achieving tariff approvals and changes.

In approving these market-based rates, the Commission required, *inter alia*, that the seller and any of its affiliates lack market power or mitigate any market power that they may have possessed.[48] The major concern of the Commission was whether the seller or its affiliates could limit competition and thereby drive up prices. A key inquiry became whether the seller or its affiliates owned or controlled transmission facilities in the relevant service area and therefore, by denying access or imposing discriminatory terms or conditions on transmission service, could foreclose other

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46 Energy Information Administration, *Electric Power Annual 1993* (December 1994) 124 (Table 77).

47 Black & Pierce, *supra* at p. 1349 n.25.

48 *See, e.g., Ocean State Power*, 44 FERC ¶61,261 (1988); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶61,368 (1990); *Citizens Power & Light Company*, 48 FERC ¶61,210 (1989); *Orange and Rockland Utilities, Inc.*, 42 FERC ¶61,012 (1988); *Doswell Limited Partnership*, 50 FERC ¶61,251 (1990) (*Doswell*); and *Dartmouth Power Associates Limited Partnership*, 53 FERC ¶61,117 (1990).

generators from competing.[49] As we have previously explained:

The most likely route to market power in today's electric utility industry lies through ownership or control of transmission facilities. Usually, the source of market power is dominant or exclusive *ownership* of the facilities. However, market power also may be gained without ownership. Contracts can confer the same rights of control. Entities with contractual control over transmission facilities can withhold supply and extract monopoly prices just as effectively as those who control facilities through ownership.[50]

As entry into wholesale power generation markets increased, the ability of customers to gain access to the transmission services necessary to reach competing

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suppliers became increasingly important.[51] In addition, beginning in the late 1980s, in order to mitigate their market

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[49] *See, e.g., Doswell*, 50 FERC at p. 61,757.

[50] *Citizens Power & Light Corporation*, 48 FERC ¶61,210, at p. 61,777 (1989) (emphasis in original); *see also Utah Power & Light Company, PacifiCorp and PC/UP&L Merging Corporation*, 45 FERC ¶61,095, at pp. 61,287-89 (1988), *order on reh'g*, 47 FERC ¶61,209, *order on reh'g*, 48 FERC ¶61,035 (1989), *remanded in part sub nom. Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991), *order on remand*, 57 FERC ¶61,363 (1991).

[51] In earlier years, a few customers were able to obtain access as a result of litigation, beginning with the Supreme Court's decision in *Otter Tail Power Company v. United States*, 410 U.S. 366 (1973). Additionally, some customers gained access by virtue of Nuclear Regulatory Commission license conditions and voluntary preference power transmission arrangements associated with federal power marketing agencies. *See, e.g., Consumers Power Company*, 6 NRC 887, 1036-44 (1977) and *The Toledo Edison Company and Cleveland Electric Illuminating Company*, 10 NRC 265, 327-34 (1979). *See Florida Municipal Power Agency v. Florida Power and Light Company*, 839 F. Supp. 1563 (M.D. Fla. 1993). *See also* Electricity Transmission:

power to meet Commission conditions, public utilities seeking Commission approval of mergers or consolidations under section 203 of the FPA or Commission authorization for blanket approval of market-based rates for generation services under section 205 of the FPA, filed "open access" transmission tariffs of general applicability.[52] The Commission applied its market rate analysis to IOUs, as well as IPPs, APPs, and marketers, and allowed IOUs to sell at market-based rates only if they opened their transmission systems to competitors.[53] The Commission also approved proposed mergers on the condition that the merging companies remedy anticompetitive effects potentially caused by the merger by filing "open access" tariffs. These early "open access" tariffs required only that the companies provide point-to-point transmission services, which is a much narrower requirement than that being imposed in this Rule and did not require transmission owners to provide to others the same quality of service that they themselves enjoyed.

Realities, Theory and Policy Alternatives, The Transmission Task Force Report to the Commission, October 1989, 197.

52 *See, e.g., Public Service Company of Colorado*, 59 FERC ¶61,311 (1992), *reh'g denied*, 62 FERC ¶61,013 (1993); *Utah Power & Light Company, et al.*, Opinion No. 318, 45 FERC ¶61,095 (1988), *order on reh'g*, Opinion No. 318-A, 47 FERC ¶61,209 (1989), *order on reh'g*, Opinion No. 318-B, 48 FERC ¶61,035 (1989), *aff'd in relevant part sub nom. Environmental Action Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991); *Northeast Utilities Service Company (Public Service Company of New Hampshire)*, Opinion No. 364-A, 58 FERC ¶61,070, *reh'g denied*, Opinion No. 364-B, 59 FERC ¶61,042, *order granting motion to vacate and dismissing request for rehearing*, 59 FERC ¶61,089 (1992), *affirmed in relevant part sub nom. Northeast Utilities Service Company v. FERC*, 993 F.2d 937 (1st Cir. 1993).

53 *See, e.g., Public Service of Indiana, Inc.*, 51 FERC ¶61,367 (1990), *reh'g denied*, 52 FERC ¶61,260 (1990), *appeal dismissed sub nom. Northern Indiana Public Service Company v. FERC*, 954 F.2d 736 (D.C.Cir. 1992).

Following PURPA, the economic and technological changes in the transmission and generation sectors helped give impetus to the many new entrants in the generating markets who could sell electric energy profitably with smaller scale technology at a lower price than many utilities selling from their existing generation facilities at rates reflecting cost. However, it became increasingly clear that the potential consumer benefits that could be derived from these technological advances could be realized only if more efficient generating plants could obtain access to the regional transmission grids. Because many traditional vertically integrated utilities still did not provide open access to third parties and still favored their own generation if and when they provided transmission access to third parties, barriers continued to exist to cheaper, more efficient generation sources.

D. The Energy Policy Act

In response to the competitive developments following PURPA, and the fact that PUHCA and lack of transmission access remained major barriers to new generators, Congress enacted Title VII of the Energy Policy Act of 1992 (Energy Policy Act).[54] A goal of the Energy Policy Act was to promote greater competition in bulk power markets by encouraging new generation entrants, known as exempt wholesale generators (EWGs), and

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by expanding the Commission's authority under sections 211 and 212 of the FPA to approve applications for transmission services.[55]

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[54] Pub. L. No. 102-486, 106 Stat. 2776 (1992), codified at, among other places, 15 U.S.C. §79z-5a and 16 U.S.C. §§796 (22-25), 824j-l.

[55] *See El Paso Electric Company and Central and South West Services Inc.*, 68 FERC ¶61,181, at p. 61,914 (1994) *(CSW)*; *see also* Paul Kemezis, FERC's Competitive Muscle: The Comparability Standard,

An EWG is defined as

Any person determined by the Federal Energy Regulatory Commission to be engaged directly, or indirectly through one or more affiliates as defined in [PUHCA] section 2(a)(11)(B), and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale.[56]

If the Commission, upon an application, determines that a person is an EWG, that person will be exempt from PUHCA.[57] This provision removed a significant impediment to the development of IPPs and APPs by allowing them to develop projects as EWGs free from the strictures of PUHCA or the QF PURPA limitations.

While sections 211 and 212, as enacted by PURPA, were intended to provide greater access to the transmission grid, the limitations placed on these sections made them unusable in virtually all circumstances.[58] However, as amended by the Energy Policy Act, these sections now give the Commission broader authority to order transmitting utilities to provide wholesale transmission services, upon application, to any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

The Energy Policy Act also added section 213 to the FPA. Section 213(a) requires a transmitting utility that does not agree to provide wholesale transmission service in accordance with a good faith request to provide a written

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Electrical World 45 (Jan.1995) ("In EPAct, Congress made it clear that the electric-power industry was to move toward a fully competitive market system, but left most of the implementation to FERC.").

56 15 U.S.C. §79z-5a.

57 15 U.S.C. §79z-5a(e).

58 *See supra* note 36.

explanation of its proposed rates, terms, and conditions and its analysis of any physical or other constraints.[59] Section 213(b) required the Commission to enact a rule requiring transmitting utilities to submit annual information concerning potentially available transmission capacity and known constraints.[60]

E. The Present Competitive Environment

Following the Energy Policy Act, the Commission established rules: (1) For certain generators to obtain EWG status and thus an exemption from PUHCA;[61] and (2) that required transmission information availability. The Commission also pursued a number of initiatives aimed at fostering the development of more competitive bulk power markets, including aggressive implementation of section 211,

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[59] *See* Policy Statement Regarding Good Faith Requests for Transmission Services and Responses by Transmitting Utilities Under Sections 211(a) and 213(a) of the Federal Power Act, as Amended and Added by the Energy Policy Act of 1992, 58 FR 38964 (July 21, 1993), *FERC Statutes and Regulations* ¶30,975 (1993) (Policy Statement Regarding Good Faith Requests for Transmission Services).

[60] *See* New Reporting Requirements Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibilities Under the Energy Policy Act of 1992, and Conforming and Other Changes to Form No. FERC-714, 58 FR 52420 (October 8, 1993), *FERC Statutes and Regulations* ¶30,980 (Order No. 558), *reh'g denied*, Order No. 558-A, 65 FERC ¶61,324 (1993), *regulations modified*, 59 FR 15333 (April 1, 1994), *FERC Statutes and Regulations* ¶30,993.

[61] *See* Order No. 550, Filing Requirements and Ministerial Procedures for Persons Seeking Exempt Wholesale Generator Status, 58 FR 8897 (February 18, 1993), *FERC Statute and Regulations* ¶30,964, *order on reh'g*, Order No. 550-A, 58 FR 21250 (April 20, 1993), *FERC Statutes and Regulations* ¶30,969 (1993). As recognized by Congress and the Commission, availability of transmission information is critical in developing competitive markets. See *supra* notes 59 and 60. This opened the "black box" of information that previously was available only to transmission owners.

a new look at undue discrimination under the FPA, easing of market entry for sellers of generation from new facilities, and initiation of a number of industry-wide reforms. As stated by the Commission, in recognition of the Congressional goal in

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the Energy Policy Act of creating competitive bulk power markets:

Our goal is to facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.[62]

1. Use of Sections 211 and 212 to Obtain Transmission Access

The Commission has aggressively implemented sections 211 and 212 of the FPA, as amended by the Energy Policy Act, in order to promote competitive markets.[63] When wheeling requests under sections 211 and 212 have been made, the Commission has required wheeling in almost all of the requests it has processed. To date, the Commission has issued orders (proposed or final) requiring wheeling in 12 of the 14 cases it has acted on.[64]

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62 *See* Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Notice of Proposed Rulemaking, 59 FR 35274 (July 11, 1994), *FERC Statutes and Regulations* ¶32,507, at p. 32,866 (Stranded Cost NOPR); *American Electric Power Service Corporation*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

63 16 U.S.C.A. §§824j-824k (West 1985 and Supp. 1994).

64 *See, e.g.*, final orders issued in *City of Bedford*, 68 FERC ¶61,003 (1994), *reh'g denied*, 73 FERC ¶61,322 (1995); *Florida Municipal Power Agency v. Florida Power & Light Company*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996); *Minnesota Municipal Power Agency*, 68 FERC ¶61,060 (1994); and *Tex-La Electric Cooperative of Texas*, 69 FERC ¶61,269 (1994); *see also* Appendix A.

As a general matter, section 211 has permitted some inroads to be made by customers in obtaining transmission service from public utilities that historically have declined to provide access to their systems, or have offered service only on a discriminatory basis. Under section 211, the Commission has granted requests for the broader type of service that most utilities historically have refused to provide--network service. Although transmission owners have provided limited amounts of unbundled point-to-point transmission service, third-party customers have not been able to obtain the flexibility of service that transmission owners enjoy.

In *Florida Municipal*, a section 211 case, the Commission ordered "network," rather than the narrower "point-to-point," service.[65] Network service permits the applicant to fully integrate load and resources on an instantaneous basis in a manner similar to the transmission owner's integration of its own load and resources. At the same time, the Commission made the generic finding that the availability of transmission service will enhance competition in the market for power supplies and lead to lower costs for consumers. The Commission explained that as long as the transmitting utility is fully and fairly compensated and there

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[65] *See Florida Municipal Power Agency v. Florida Power & Light Company*, 65 FERC ¶61,125, *reh'g dismissed*, 65 FERC ¶61,372 (1993), *final order*, 67 FERC ¶61,167 (1994), *order on reh'g*, 74 FERC ¶61,006 (1996). The Commission has "characterized point-to-point service as involving designated points of entry into and exit from the transmitting utility's system, with a designated amount of transfer capability at each point." *El Paso Electric Company v. Southwestern Public Service Company*, 68 FERC ¶61,182, at p. 61,926 n.9 (1994) (*citing Entergy Services, Inc.*, 58 FERC ¶61,234, at p. 61,768 (1993), *reh'g dismissed*, 68 FERC ¶61,399 (1994)). Network service allows more flexibility by allowing a transmission customer to use the entire transmission network to provide generation service for specified resources and specified loads without having to pay multiple charges for each resource-load pairing.

is no unreasonable impairment of reliability, transmission service is in the public interest.[66]

As discussed *infra*, based on the mounting competitive pressures in the industry and rapidly evolving markets, we have concluded that section 211 alone is not enough to eliminate undue discrimination. The comments received on the proposed rules, discussed in detail *infra*, confirm this conclusion. The significant time delays involved in filing an individual service request for bilateral service under section 211 place the customer at a severe disadvantage compared to the transmission owner and can result in discriminatory treatment in the use of the transmission system. It is an inadequate procedural substitute for readily available service under a filed non-discriminatory open access tariff. As the Commission noted in *Hermiston Generating Com-*

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pany, "[t]he ability to spend time and resources litigating the rates, terms and conditions of transmission access is not equivalent to an enforceable voluntary offer to provide comparable service under known rates, terms and conditions."[67]

2. Commission's Comparability Standard

In the Spring of 1994, the Commission began to address the problem of the disparity in transmission service that utilities provided to third parties in comparison to their own uses of the transmission system. In the seminal case in this area, *American Electric Power Service Corporation* (*AEP*), the company voluntarily proposed a tariff of general applicability that would offer firm, point-to-point

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66 *Florida Municipal*, 67 FERC at p. 61,477.

67 69 FERC ¶61,035, at p. 61,165 (1994), *reh'g denied*, 72 FERC ¶61,071 (1995); *see also Southwest Regional Transmission Association*, 69 FERC ¶61,100, at p. 61,398 (1994), *order on compliance filing*, 73 FERC ¶61,147 (1995) (*SWRTA*).

transmission service for a minimum of one month.[68] The Commission accepted the proposed transmission tariff for filing and suspended its effectiveness for one day, subject to refund.[69] Rehearing requests challenged the Commission's summary approval of the restriction of service to point-to-point as being discriminatory and anticompetitive.[70] The rehearing requests argued that the tariff should be expanded to include network services such as those used by the transmission owner. On rehearing, the Commission announced a new standard for evaluating claims of undue discrimination.

The Commission found that a voluntarily offered, new open access transmission tariff that did not provide for services comparable to those that the transmission owner provided itself was unduly discriminatory and anticompetitive.[71] In reaching that conclusion, the Commission broadened its undue discrimination analysis (which traditionally had focused on the rates, terms, and

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[68] 64 FERC ¶61,279 (1993), *reh'g granted*, 67 FERC ¶61,168, *clarified*, 67 FERC ¶61,317 (1994).

[69] The Commission explained that AEP could limit the service it was offering because it was "providing the service voluntarily under a tariff of general applicability." 64 FERC at p. 62,978.

[70] *AEP*, 67 FERC at p. 61,489.

[71] With respect to anticompetitive effects, the Commission explained that it has "adhered to the Supreme Court's determination that the Commission's 'important and broad regulatory power * * * carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to sections 202 and 203, and under like directives contained in sections 205, 206 and 207.' *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1972)." *Id.* at p. 61,490 (footnote omitted). The Commission reaffirmed that it would examine how best to fulfill this responsibility, as well as its responsibility to prevent undue discrimination, in light of the changing conditions in the electric utility industry. *Id.*

conditions faced by similarly situated third-party customers) to include a focus on the rates, terms, and conditions of a utility's own uses of the transmission system:

[A]n open access tariff that is not unduly discriminatory or anticompetitive should offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider's uses of its system.[72]

Refocusing the analysis was necessitated by the changing conditions in the electric utility industry, including the emergence of non-traditional suppliers and greater competition in bulk power markets. Because a transmission provider may use its system in different ways (*e.g.*, to integrate load and resources when serving retail native load, to make off-system sales or purchases, or to serve wholesale requirements customers), the Commission set for hearing the factual issues associated with identifying those uses, as well as any potential impediments or consequences to providing comparable services to third parties.[73]

After *AEP*, the Commission applied this comparability standard to a proposed open access transmission tariff that was filed by Kansas City Power & Light Company (KCP&L) in support of a proposal to sell generation at market-based rates.[74] The Commission explained that, in light of *AEP*, the utility's proposed open access transmission tariff (which provided only

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for point-to-point service) did not adequately mitigate its transmission market power so as to justify allowing the

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72 *Id.* at p. 61,490.

73 *Id.* at pp. 61,490-91.

74 *See Kansas City Power & Light Company*, 67 FERC ¶61,183 (1994), *reh'g pending*.

requested market-based rates. KCP&L could charge market-based rates for sales only if it modified its proposed transmission tariff to reflect the *AEP* comparability standard.

Since then, the Commission has required comparable service in a variety of contexts, and has set for hearing the factual issues associated with comparable service. For example, the Commission found that market power can be adequately mitigated only if a merged company offers transmission services in accordance with the *AEP* comparability standard.[75] The Commission further held that, even if a merger does not result in an increase in market power, the merger would not be consistent with the public interest under section 203 of the FPA unless the merged company offers comparable transmission services, as defined in *AEP*.[76] The Commission therefore announced a transmission comparability requirement for all new mergers:

Given the transition of the electric utility industry as a whole, we conclude that, absent other compelling public interest considerations, coordination in the public interest can best be secured only if merging utilities offer comparable transmission services.[77]

In *Heartland Energy Services, Inc.*,[78] the Commission applied its comparability standard to an affiliated electric power marketer seeking blanket authorization to sell electricity at market-based rates. The Commission explained that

> For all future cases involving blanket approval of market-based rates an offer of comparable transmission services will be required before the

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75 *E.g., CSW, supra*, 68 FERC at p. 61,914.

76 *Id.*

77 *Id.* at p. 61,915 (footnote omitted).

78 *68 FERC* ¶61,223 (1994).

> Commission will be able to find that transmission market power has been adequately mitigated. In the context of an affiliated power marketer, this means that all of its affiliated utilities must have a comparable transmission tariff on file.[79]

The Commission also denied a request by a company affiliated with a transmission-owning utility seeking permission to sell power at market-based rates to a particular customer. The denial was without prejudice to refiling such a request in a new section 205 proceeding, but only after the affiliated transmission-owning utility filed a comparable transmission service tariff.[80] The Commission added that it

> will require comparability in any situation in which a seller seeking market-based rates is affiliated with an owner or controller of transmission facilities.[81]

The Commission has also stated that "it will henceforth apply the transmission comparability standard announced in the *AEP* case to all transmitting utility members of an RTG."[82]

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79 *Id.* at p. 62,060. *In InterCoast Power Marketing Company*, 68 FERC ¶61,248, *clarified*, 68 FERC ¶61,324 (1994), the Commission rejected an affiliated marketer's proposal to sell at market rates without its affiliate utility offering comparable transmission services. The Commission stated that the only way to ensure that InterCoast does not have transmission market power is to require its affiliated public utility to offer comparable transmission services. *See also LG&E Power Marketing Inc.*, 68 FERC ¶61,247, at pp. 62,120-21 (1994). The Commission added that this is consistent with encouraging competitive bulk power markets as envisioned by the Energy Policy Act of 1992. *Id.* at p. 62,132.

80 *See Hermiston Generating Company*, 69 FERC ¶61,035, at p. 61,164 (1994), *reh'g pending*. The Commission subsequently accepted the rates on a cost basis. See Letter Order dated November 10, 1994.

81 *Id.* at p. 61,165.

82 *See SWRTA*, 69 FERC at p. 61,397; *see also PacifiCorp, the California Municipal Utilities Association, and the Independent Energy*

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The Commission further declared that comparable services must be provided through "open access" tariffs rather than only on a contract-by-contract basis:

[T]ariffs are essential to the provision of comparable services. Tariffs set out the services that are available and the terms and conditions under which those services will be made available * * *. [In contrast], a negotiation process creates uncertainty and imposes on customers delay and other transaction costs that the transmitting utility members of an RTG do not incur when using the transmission for their own benefit. Moreover, the ability to execute separate transmission agreements with different but similarly situated customers is the ability to unduly discriminate among them. A tariff ensures against such discrimination in the RTG.[83]

Thus, the Commission required the RTGs to amend their bylaws to commit all transmitting utility members to offer comparable transmission services to other RTG members pursuant to a transmission tariff or tariffs.

As discussed below, since the *AEP* comparability standard was announced, the Commission has set for hearing 44 open access tariffs to determine what constitutes comparable service. This number includes tariffs filed subsequent to the Open Access NOPR. All tariffs have now been made subject to the outcome of the Final Rule.

Producers (on behalf of Western Regional Transmission Association), 69 FERC ¶61,099, *order on reh'g*, 69 FERC ¶61,352 (1994), *order on compliance filing*, 71 FERC ¶61,158 (1995) (*WRTA*). An RTG is a regional transmission group. It is defined as "a voluntary organization of transmission owners, transmission users, and other entities interested in coordinating transmission planning (and expansion), operation and use on a regional (and inter-regional." Policy Statement Regarding Regional Transmission Groups, 58 FR 41626 (August 5, 1993), *FERC Statutes and Regulations* ¶30,976, at p. 30,870 n.4 (RTG Policy Statement).

83 *SWRTA*, 69 FERC at p. 61,398.

3. Lack of Market Power in New Generation

In 1994 in the *KCP&L* case, discussed in the prior section, the Commission continued to recognize that transmission remains a natural monopoly. However, it found that, in light of the industry and statutory changes that now allow ease of market entry, no wholesale seller of generation has market power in generation from *new* facilities.[84] In particular, the Commission explained that it had previously noted in *Entergy Services, Inc.* that

There was significant evidence that non-traditional power project developers, including qualifying facilities and independent power projects, are becoming viable competitors in long-run markets.[85]

The Commission further explained that since *Entergy*, Congress had enacted the Energy Policy Act, which had lowered barriers to the entry of new suppliers by creating a new class of power suppliers--EWGs--that are exempt from the provisions of PUHCA.[86] The Commission concluded that, in considering market-based rate proposals for generation sales, it need only focus on market power in transmission, generation market power in short-run markets, and other barriers to entry.[87]

4. Further Commission Action Addressing a More Competitive Electric Industry

To address the fact that the electric industry is becoming more competitive, and to remove barriers that might inhibit a

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84 *KCP&L*, 67 FERC ¶61,183 (1994).

85 *Id.* at p. 61,557 (*citing Entergy Services, Inc.*, 58 FERC ¶61,234, at p. 61,756 and nn.63 and 65 (*Entergy*)).

86 *Id.* The Commission added that "after examining generation dominance in many different cases over the years, we have yet to find an instance of generation dominance in long-run bulk power markets." *Id.*

87 *Id.*

more competitive industry, the Commission has initiated a number of proceedings: (1) Stranded Cost NOPR,[88] (2) Transmission Pricing Policy Statement,[89] (3) Pooling Notice of Inquiry,[90] (4) Regional Transmission Group (RTG) Policy Statement,[91] and (5) Notice of Inquiry on Merger Policy.[92]

In the Stranded Cost NOPR the Commission recognized that the trend toward greater transmission access and the transition

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to a fully competitive bulk power market could cause some utilities to incur stranded costs as wholesale requirements customers (or retail customers) use their supplier's transmission to purchase power elsewhere. As the Commission noted, a utility may have built facilities or entered into long-term fuel or purchased power supply contracts with the reasonable expectation that its customers would renew their contracts and would pay their share of long-term investments and other incurred costs. If the customer obtains another power supplier, the utility may have stranded costs. If the utility cannot locate an alternative buyer or somehow mitigate the stranded costs, the Commission explained that "the costs must be recovered from either the departing customer or the remaining

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88 *FERC Statutes and Regulations* ¶32,507 (1994).

89 Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act, 59 FR 55031 (November 3, 1994), *FERC Statutes and Regulations* ¶31,005 (Transmission Pricing Policy Statement).

90 Inquiry Concerning Alternative Power Pooling Institutions Under the Federal Power Act, 59 FR 54851 (October 26, 1994), *FERC Statutes and Regulations* ¶35,529 (1995) (Pooling Notice of Inquiry).

91 *FERC Statutes and Regulations* ¶30,976 (RTG Policy Statement).

92 *FERC Statutes and Regulations* ¶35,531 (1996).

customers or borne by the utility's shareholders."[93] Accordingly, the Commission proposed to establish provisions concerning the recovery of wholesale and retail stranded costs by public utilities and transmitting utilities.

In the Transmission Pricing Policy Statement, the Commission announced a new policy providing greater flexibility in the pricing of transmission services provided by public utilities and transmitting utilities. The Commission traditionally had allowed only postage-stamp, contract-path pricing.[94] Under the new policy, we will permit a variety of proposals, including distance sensitive and flow-based pricing, which may be more suitable for competitive wholesale power markets.[95] The Commission explained that this "[g]reater pricing flexibility is appropriate in light of the significant competitive changes occurring in wholesale generation markets, and in light of our expanded wheeling authority under the Energy Policy Act of 1992."[96] However, the Commission explained that any new transmission pricing

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93 *FERC Statutes and Regulations* ¶32,507, at p. 32,864.

94 Most transmission contracts set a single price for energy flow over a utility's transmission system. This single-price policy is called "postage stamp" pricing because the rate does not depend on how far the power moves within a company's transmission system. If power flows through several companies, traditional industry practice is to specify that power flows along a "contract path" consisting of the transmission-owning utilities between the ultimate receipt and delivery points. *See Indiana Michigan Power Company*, 64 FERC ¶61,184, at p. 62,545 (1993).

95 Unlike with postage stamp pricing, with distance-sensitive pricing the cost of moving power through a company depends on how far the power moves within the company. In contrast to contract path pricing, flow-based pricing establishes a price based on the costs of the various parallel paths actually used when the power flows. Because flow-based pricing can account for all parallel paths used by the transaction, all transmission owners with facilities on any of the parallel paths could be compensated for the transaction.

96 *FERC Statutes and Regulations* ¶31,005, at p. 31,136.

proposal must meet the Commission's *AEP* comparability standard. The Commission further explained that comparability of service applies to price as well as to terms and conditions.[97]

The Commission issued the Pooling Notice of Inquiry to receive comments on traditional power pools and on alternative power pooling institutions that are being explored in today's more competitive environment. The Commission expressed concern that

[G]iven the ongoing changes in the competitive environment of the electric utility industry--in particular, the potential for substantially increased access to transmission--we must consider whether we are appropriately balancing our dual objectives of promoting coordination and competition.[98]

Accordingly, the Commission explained that it wished to look at alternative power pooling institutions and to re-examine the role of more traditional power pools in today's environment of increased competition. In particular the Commission expressed its intent to ensure that its policies "are consistent with the development of a competitive bulk power market."[99]

In the RTG Policy Statement, the Commission announced a policy encouraging the development of RTGs. The Commission explained that a primary purpose of RTGs is to facilitate transmission access for potential users and voluntarily resolve

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97 *Id.* at p. 31,142.

98 *FERC Statutes and Regulations* ¶35,529, at p. 35,715.

99 *Id.* at p. 35,714. As explained below, the Commission held technical conferences on issues surrounding power pools and competition.

disputes over such service. The Commission has approved the formation of three RTGs.[100] One of the conditions is that each RTG member must offer comparable transmission services by tariff to other RTG members.

In the merger NOI, the Commission indicated that it will review whether its criteria and policy for evaluating mergers need to be modified in light of the changing circumstances occurring in the electric industry.

In addition to the Commission's actions, a number of states have initiated proceedings concerning retail wheeling or proposed legislation for retail wheeling, that is, for ultimate consumers to choose their supplier of power, or other restructuring proposals.[101]

5. Events Since Issuance of Open Access NOPR

Since issuance of the Open Access NOPR, public utilities have filed, in some form or another, 47 open access tariffs. In acting on those filings, the Commission has made

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[100] *See WRTA* and *SWRTA, supra, and Northwest Regional Transmission Association*, 71 FERC ¶61,397 (1995).

[101] At least 12 states have retail wheeling proposals, legislation, or pilot programs underway-- Alabama, California, Connecticut, Illinois, Massachusetts, Michigan, New Hampshire, New York, Ohio, Rhode Island, Vermont, and Wisconsin. At least 14 other states are investigating retail wheeling. Currently, according "to a report of the NARUC-affiliated National Council on competition and the Electric Industry, 41 States are actively involved in investigating whether and how to restructure their respective electric power markets. Of this total, 29 State regulatory authorities * * * have initiated investigations. In addition, five State legislatures are involved in similar investigations, while seven other States have joint regulatory/legislative proceedings underway."

Testimony of the Honorable Cheryl L. Parrino, Chair of the Wisconsin Public Service Commission, on behalf of the National Association of Regulatory Utility Commissioners, before the United States Senate Committee on Energy and Natural Resources (March 6, 1996).

all of the non-rate terms and conditions of those proposed tariffs subject to the outcome of this Final Rule.[102]

Over the last year, the Commission also has received and analyzed more than 20,000 pages of comments that were received from over 400 commenters, as well as additional information provided by industry participants at a number of Commission-initiated technical conferences.[103] Those technical conferences addressed several issues--ancillary services, pro forma tariffs, power pools, and ISOs--and provided significant input to the Commission's formulation of this Final Rule.

F. Need for Reform

The many changes discussed above have converged to create a situation in which new generating capacity can be built and operated at prices substantially lower than many utilities' embedded costs of generation. As discussed above, new generation facilities can produce power on the grid at a cost of less than 3 cents per kWh to 5 cents per kWh, yet the costs for large plants constructed and installed over the last decade were typically in the range of 4 to 7 cents per kWh for coal plants and 9 to 15 cents for nuclear plants.

Non-traditional generators are taking advantage of this opportunity to compete. Indeed, the non-traditional generators' share of total U.S. electricity generation increased from 4 percent in 1985 to 10 percent in 1993.[104] Much of this increased share of generation is the result of competitive bidding for new generation resources that has

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[102] *See American Electric Power Service Corporation*, et al., 72 FERC ¶61,287, at p. 61,238 (1995).

[103] Attached to this Final Rule as Appendix B is a list of commenters and the abbreviations used to designate them, including those commenters that filed late.

[104] Energy Information Administration, *Performance Issues for a Changing Electric Power Industry* (January 1995) 10 and (Figure 5).

occurred in 37 states. Since 1984, almost 4,000 projects, representing over 400,000 MW, have been offered in response to requests. Over 350 projects have been selected to supply 20,000 MW, and, of these, 126 are now online producing almost 7,800 MW of power. [105]

In addition, the cost of utility-generated electricity differs widely across the major regions of the United States. Average utility rates range from 3 to 5 cents in the Northwest to 9 to 11 cents in Califor-

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nia. Electricity consumers are demanding access to lower cost supplies available in other regions of the United States, and access to the newer, lower cost generation resources. Therefore, it is important that the non-traditional generators of cheaper power be able to gain access to the transmission grid on a non-discriminatory open access basis.

The Commission's goal is to ensure that customers have the benefits of competitively priced generation. However, we must do so without abandoning our traditional obligation to ensure that utilities have a fair opportunity to recover prudently incurred costs and that they maintain power supply reliability. As well, the benefits of competition should not come at the expense of other customers. The Commission believes that requiring utilities to provide non-discriminatory open access transmission tariffs, while simultaneously resolving the extremely difficult issue of recovery of transition costs (discussed *infra*), is the key to reconciling these competing demands.

Non-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and the lower consumer prices achievable

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105 Current Competition, November 1994, Vol. 5, No. 8, at p. 8.

through such competition.[106] Transmitting utilities own the transportation system over which bulk power competition occurs and transmission service continues to be a natural monopoly. Denials of access (whether they are blatant or subtle), and the potential for future denials of access, require the Commission to revisit and reform its regulation of transmission in interstate commerce. As discussed in detail in Section IV.B., such action is required by the FPA's mandate that the Commission remedy undue discrimination.

Since the time the NOPR issued, the Commission staff has completed an FEIS that provides a quantitative estimate of some of the cost savings expected from this Rule: approximately $3.8 to $5.4 billion per year. Other non-quantifiable benefits are also expected from this Rule and include: (1) better use of existing assets and institutions; (2) new market mechanisms; (3) technical innovation; and (4) less rate distortion. These potential benefits to the Nation's electricity consumers and the economy as a whole confirm the need to take generic action to remove barriers to competition. In what follows, we set out the changes necessary to remedy undue discrimination and to ensure a fair transition to a more competitive regulatory regime.

IV. Discussion

A. Scope of the Rule

1. Introduction

The Commission has determined that non-discriminatory open access transmission services (including access to transmission information) and stranded cost recovery are the most critical components of a successful transition to competitive wholesale electricity markets. These issues are

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[106] As discussed above, a significant number of public utilities still do not have any form of an "open access" tariff on file with the Commission and no public utility has on file a non-discriminatory open-access tariff as defined by this Rule.

the focal point of this Rule, the accompanying rule on open access same-time information systems, and the accompanying proposed rule on capacity reservation tariffs.

In undertaking these initiatives, however, we are mindful that they are part of a broader picture of evolving issues affecting the electric industry and that other Commission policies will play an important role in ensuring the full development of competitive markets. Among the many issues that are important to competitive bulk power markets are: independent system operators (ISOs); regional transmission groups; generation market power; utility merger policy; and the development of innovative transmission pricing alternatives, such as flow-based, distance-sensitive transmission pricing methodologies that reflect incremental costs. In particular, we believe that ISOs have great potential to assist us and the industry to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power. Although we discuss some of these issues in this Rule, we will further develop our policies in other proceedings as well to accommodate and encourage more efficient market structures.

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We now address the comments received on the scope of the proposed rulemaking.

2. Functional Unbundling

In the NOPR, the Commission preliminarily found that functional unbundling of wholesale generation and transmission services is necessary to implement non-discriminatory open access transmission.[107] At the same time, the Commission explained that the proposed rule would

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107 *FERC Statutes and Regulations* ¶32,514, at p. 33,080.

accommodate, but not require, corporate unbundling (which could include selling generation or transmission assets to a non-affiliate (divestiture) or the less aggressive step of establishing separate corporate affiliates to manage a utility's transmission and generation assets). However, we invited comments on functional unbundling and asked whether it is a strong enough measure to ensure non-discriminatory open access transmission without some form of corporate restructuring.

Comments

Commenters take both sides on whether functional unbundling is sufficient to assure non-discriminatory open access transmission or whether a stronger measure, such as corporate unbundling, is needed.

Supporting Functional Unbundling

Various commenters, including utilities and state commissions, generally support functional unbundling as sufficient to assure non-discriminatory open access transmission and oppose requiring corporate unbundling or divestiture.[108] Several commenters state that functional unbundling will remedy discrimination without creating the inefficiencies and additional costs that corporate restructuring would create.[109]

A number of other commenters argue that the Commission has no authority under the FPA to require

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[108] *E.g.*, Ohio Edison, UtiliCorp, Pennsylvania P&L, Atlantic City, Montana Power, IL Com, Seattle, OK Com, TX Industrials, MidAmerican, Southwestern, Southern, DOD, Public Service Co of CO, SC Public Service Authority, Florida Power Corp, DOE, WP&L, Com Ed, SBA, Consumers Power, CA Com, UT Com, Houston L&P, KCPL, EEI.

[109] *E.g.*, Florida Power Corp, El Paso, PSNM, and SC Public Service Authority.

divestiture of transmission assets.[110] Several of these commenters assert that, even if the Commission has the authority, the electric industry, unlike the natural gas industry, is not ready for mandated corporate unbundling because electric utilities still serve a high percentage of retail customers and own large amounts of the generating capacity. They assert that transmission system operation requires the operator to have control over much of the generating capacity.

Various other commenters also support functional unbundling, but believe that safeguards are needed to make it work[111] Power Marketing Association, for example, suggests a number of safeguards: adoption of cost allocation mechanisms to ensure that utilities do not shift costs from generation to transmission; random audits of utility books; a requirement that each utility file a code of conduct that provides for maximum separation of generation and transmission functions; and active oversight and complaint procedures with strong penalties for abuse. OK Com and GA Com believe that functional unbundling along with the safeguard of the Commission's complaint process will provide sufficient incentive for non-discriminatory open access transmission.

Supporting Corporate Unbundling

A number of commenters see weaknesses in functional unbundling and argue that some form of corporate unbundling is necessary to assure non-discriminatory open

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110 *E.g.*, Southwestern, PECO, El Paso, Florida Power Corp, NSP, Public Service E&G, MidAmerican.

111 *E.g.*, NRECA, IN Com, Power Marketing Association, TDU Systems, NorAm, Turlock, Texaco, Utility Shareholders, NSP, El Paso, Utility Investors Analysts, PECO, Florida Power Corp, UT Com, Sierra, Carolina P&L, SoCal Gas, OK Com, FL Com, Southern.

access transmission.[112] American Forest & Paper says that there is affiliate abuse in the gas industry and argues that

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the electric industry presents even more serious potential for abuse because it is still dominated by vertically integrated utilities.[113] UAMPS asserts that functional unbundling is insufficient because the utility will still favor itself on issues related to transmission planning, capital investment, and operation and maintenance and replacement costs.

NIEP argues that divestiture of generation assets from transmission and distribution is the preferred mechanism for mitigating market power. It further suggests that if corporate divestiture is not feasible the Commission should

> seek to achieve "virtual divestiture" by requiring that the utility generation function be separated from transmission and distribution functions in a separate corporate affiliate, or business unit, and that affiliate transaction rules be established to guard against possible abuses.[114]

It maintains that the Commission has broad authority to protect against undue discrimination and anticompetitive behavior and can order divestiture if such action is required to remedy such behavior.[115]

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[112] *E.g.*, American Forest & Power, American National Power, ND Com, IL Com, UAMPS, NIEP, APPA, Public Poweer Council, Municipal Energy Agency Nebraska, Missoui Basin MPA, Texaco, Direct Service Industries, Calpine, CCEM, Wisconsin Coalition, VT DPS.

[113] *See also* American National Power, ND Com, Calpine.

[114] NIEP Initial Comments at p. 4.

[115] *See also* Municipal Energy Agency Nebraska, Direct Services Industries.

FTC and DOJ argue that operational unbundling, an example of which is the formation of an independent system operator (ISO), likely would be more effective than functional unbundling and less costly than industry-wide divestiture.[116] FTC describes operational unbundling as "structural institutional arrangements, short of divestiture, that would separate operation of the transmission grid and access to it from economic interests in generation." It gives as an example the California proposal under which utilities would continue to own transmission lines, but an independent system operator would have operational control. DOJ also suggests "a separate authority" to manage the grid and access to the grid, joint ventures, and voluntary pooling arrangements. These commenters argue that operational unbundling would be easier to enforce than functional unbundling.

DOE states that separation of the control of transmission from vertically-integrated companies does not necessarily require a poolco or any particular market mechanism. It suggests the possibility of an ISO that is functionally separate from any buyer or seller of generation, but would not perform all the functions of a poolco.

United Illuminating supports "operational unbundling" that would either (1) eliminate vertical integration and divestiture of transmission assets, leading to the formation of a regional transmission company, or (2) develop a regional contractual approach to transmission services that eliminates the transmission owner's market power and fairly allocates support of the transmission facilities between native load and third-party users of the system.

Commission Conclusion

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116 Others oppose operational unbundling. *See, e.g.*, Carolina P&L, Salt River.

We conclude that functional unbundling of wholesale services is necessary to implement non-discriminatory open access transmission and that corporate unbundling should not now be required. As we explained in the NOPR, functional unbundling means three things:

(1) a public utility must take transmission services (including ancillary services) for all of its new wholesale sales and purchases of energy under the same tariff of general applicability as do others;

(2) a public utility must state separate rates for wholesale generation, transmission, and ancillary services;

(3) a public utility must rely on the same electronic information network that its transmission customers rely on to obtain information about its transmission system when buying or selling power.

We believe that these requirements are necessary to ensure that public utilities provide non-discriminatory service.[117] These requirements also will give public

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utilities an incentive to file fair and efficient rates, terms, and conditions, since they will be subject to those same rates, terms, and conditions.

However, we recognize that additional safeguards are necessary to protect against market power abuses. Functional unbundling will work only if a strong code of conduct (including a requirement to separate employees involved in transmission functions from those involved in wholesale power merchant functions) is in place. In the RINs NOPR,

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[117] When and how functional unbundling is to be achieved for requirements transactions and for various types of coordination arrangements, including power pools, is discussed at Sections IV.A.5 and IV.F. Functional unbundling of ancillary services is discussed in Section IV.D.

the Commission proposed a code of conduct that would apply to all public utility transmission providers. As the Commission explained,

> [t]his code of conduct would require, among other matters, a separation of the utilities' transmission system operations and wholesale marketing functions, and would define permissible and impermissible contacts between employees that conduct wholesale generation marketing functions and employees that handle transmission system operations and reliability in the system control center or at other facilities or locations. [118]

Adoption of this code of conduct, discussed in detail in the accompanying final rule on OASIS,[119] is needed to ensure that the transmission owner's wholesale marketing personnel and the transmission customer's marketing personnel have comparable access to information about the transmission system.

As noted by OK Com and GA Com, a further safeguard--section 206--is available if a public utility seeks to circumvent the functional unbundling requirements. Under section 206, any person is free to file a complaint with the Commission detailing any alleged misbehavior on the part of the public utility or its affiliates concerning matters subject to our jurisdiction under the FPA. Similarly, the Commission may, on its own motion, initiate a proceeding to investigate the practices of the public utility and its affiliates.

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[118] Real-Time Information Networks and Standards of Conduct, Notice of Proposed Rulemaking, 60 FR 66182 (December 21, 1995), *FERC Statutes and Regulations* ¶32,516, at p. 33,170 (1995).

[119] The final rule on information systems no longer uses the terminology RINs. The new terminology used is OASIS--Open Access Same-time Information System--which we will use in this Final Rule.

We believe that functional unbundling, coupled with these safeguards, is a reasonable and workable means of assuring that non-discriminatory open access transmission occurs. In the absence of evidence that functional unbundling will not work, we are not prepared to adopt a more intrusive and potentially more costly mechanism--corporate unbundling--at this time.

Several commenters discuss the need to encourage or even to require ISOs in the context of functional unbundling. We believe that ISOs have the potential to provide significant benefits (*e.g.*, to help provide regional efficiencies, to facilitate economically efficient pricing, and, especially in the context of power pools, to remedy undue discrimination and mitigate market power) and will further our goal of achieving a workably competitive market. As we learned at our technical conference on power pools, many utilities are examining ISOs and corporate unbundling in various shapes and forms, particularly in the context of power pools. We discuss ISOs extensively in our section on power pools where we believe they will have an important role to play. However, in the context of individual utility transactions, we believe that the less intrusive functional unbundling approach outlined above is all that we must require at this time. Nevertheless, we see many benefits in ISOs, and encourage utilities to consider ISOs as a tool to meet the demands of the competitive marketplace.

As a further precaution against discriminatory behavior, we will continue to monitor electricity markets to ensure that functional unbundling adequately protects transmission customers. At the same time, we will analyze all alternative proposals, including formation of ISOs, and, if it becomes apparent that functional unbundling is inadequate or unworkable in assuring non-discriminatory open access transmission, we will reevaluate our position and decide whether other mechanisms, such as ISOs, should be required.

Finally, while we are not now requiring any form of corporate unbundling, we again encourage utilities to explore whether corporate unbundling or other restructuring

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mechanisms may be appropriate in particular circumstances. Thus, we intend to accommodate other mechanisms that public utilities may submit, including voluntary corporate restructurings (*e.g.*, ISOs, separate corporate divisions, divestiture, poolcos), to ensure that open access transmission occurs on a non-discriminatory basis. We also will continue to monitor--and stand ready to work with parties engaging in--innovative restructuring proposals occurring around the country.

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B. Legal Authority

The Commission reaffirms its conclusion in the NOPR that we have the authority under the FPA to order wholesale transmission services in interstate commerce to remedy undue discrimination by public utilities. We analyze below the relevant cases examining our wheeling authority,

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then discuss and respond to the legal arguments raised by the commenters.

1. Bases for Legal Authority

a. Undue Discrimination/Anticompetitive Effects

In upholding the Commission's order requiring non-discriminatory open access in the natural gas industry, the court in *Associated Gas Distributors v. FERC* stated that the Natural Gas Act "fairly bristles" with concern for undue

discrimination.[193] The same is true of the FPA. The Commission has a mandate under sections 205 and 206 of the FPA to ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. We must determine whether any rule, regulation, practice or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and must prevent those contracts and practices that do not meet this standard. As discussed below, *AGD* demonstrates that our remedial power is very broad and includes the ability to order industry-wide non-discriminatory open access[194] as a remedy for undue discrimination. The *AGD* court reached this decision even in the face of prior cases that acknowledged that Congress did not mandate common carriage or explicitly empower the Commission to order direct access for either gas transporters or electric utilities. Moreover, the Commission's power under the FPA "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to [FPA] §§ 202 and 203, and under like directives contained in §§ 205, 206, and 207."[195]

Therefore, based on the mandates of sections 205 and 206 of the FPA and the case law interpreting the Commission's authority over transmission in interstate commerce, we conclude that we have ample legal authority—indeed, a responsibility—under section 206 of the

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193 *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (*AGD*).

194 We use the term "open access" to refer to a public utility's obligation to put a tariff on file offering service to eligible customers. Access is not open to all. Specifically, the tariff is not an offer to serve retail customers if state law does not permit retail wheeling.

195 *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1973).

FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination or anticompetitive effects.[196] We discuss below the primary court decisions that touch on our wheeling authority under sections 205 and 206.

The Commission's authority to order access as a remedy for undue discrimination under the Natural Gas Act (NGA) was upheld and discussed in detail in *AGD*. In *AGD*, the court upheld in relevant part the Commission's Order No. 436.[197] That order found the prevailing natural gas company practices to be "unduly discriminatory" within the meaning of section 5 of the NGA (the parallel to section 206 of the FPA) and held that if pipelines wanted blanket certification for their transportation services, they must commit to transport gas for others on a non-discriminatory basis; in other words, they must provide non-discriminatory open access.

In upholding the Commission's authority to require open access, the court first noted that the opponents' arguments against such authority must proceed "uphill." The statute contains no language forbidding the Commission to impose common carrier status on pipelines, let alone forbidding the Commission to impose "a specific duty that happens to be a typical or even core component of such status." The court found that the legislative

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196 In most situations, discrimination that precludes transmission access or gives inferior access will have at least potential anticompetitive effects because it limits access to generation markets and thereby limits competition in generation. Similarly, it is probable that any transmission provision that has anticompetitive effects would also be found to be unduly discriminatory or preferential because the anticompetitive provision would most likely favor the transmission owner *vis-a-vis* others.

197 Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶30,665 (1985).

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history cited by the opponents came nowhere near overcoming this statutory silence. Rather, the legislative history supported only the proposition that Congress itself declined to impose common carrier status.[198] Emphasizing Congress' deep concern with undue discrimination, the court found that the Commission had ample authority to "stamp out" such discrimination:

> The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress in 1906 and 1914 and 1935 and 1938 itself refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.[199]

The *AGD* court found that court decisions under the FPA did not support the view that the Commission's authority to "stamp out" undue discrimination is hamstrung by an inability to require non-discriminatory open access as a remedy. These decisions are discussed below.

One of the earliest cases on wheeling is *Otter Tail Power Company v. United States* (*Otter Tail*).[200] In that case, the Supreme Court rejected the argument that the District Court, in a civil antitrust suit, could not order wheeling because to

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198 *AGD, supra*, 824 F.2d at p. 997.

199 *Id.* at p. 998.

200 410 U.S. 366 (1974).

do so would conflict with the FPC's purported wheeling authority.[201] The Court explained that Congress had decided not to impose a common carrier obligation on the electric power industry and noted that the Commission was not at that time expressly granted power to order wheeling.[202] In effect, it concluded that because Congress did not include common carrier provisions in the FPA, the Commission must not have any express authority to order wheeling that would preclude the District Court from imposing a wheeling remedy. Nowhere, however, did the Court say that the Commission lacked authority under section 206 to remedy undue discrimination. Indeed, that was simply not a matter before the Court or of any consequence to its decision.

In the FPA, while Congress elected not to impose common carrier status on the electric power industry, it tempered that determination by explicitly providing the Commission with the authority to eradicate undue discrimination—one of the goals of common carriage regulation.[203] By providing this broad authority to the Commission, it assured itself that in preserving "the voluntary action of the utilities" it was not allowing this voluntary action to be unfettered. It would be far-reaching indeed to conclude that *Otter Tail*, which was a civil antitrust suit that raised issues entirely unrelated to our authority under section 206, is an impediment to our achieving one of the primary goals of the FPA—eradicating undue discrimination in transmission in interstate commerce in the electric power industry.

In *Richmond Power & Light Company v. FERC* (*Richmond*),[204] the FPC, in reaction to the 1973 oil embargo,

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201 410 U.S. at pp. 375-76.

202 *Id.* at pp. 374-76.

203 *See AGD*, 824 F.2d at p. 998.

204 574 F.2d 610 (D.C. Cir. 1978).

was attempting to reduce dependence on oil. The FPC requested that utilities with excess capacity wheel power to the New England Power Pool (NEPOOL). In response, several suppliers and transmission owners filed rate schedules with the FPC that provided for voluntary wheeling. Richmond Power & Light Company (Richmond) objected to these filings, claiming that they were unreasonable because they did not guarantee transmission access. The FPC refused to compel the utilities to wheel Richmond's power, stating that it did not have the authority to order a public utility to act as a common carrier.

The D.C. Circuit upheld the Commission. It acknowledged that Richmond's argument was persuasive in some respects,

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but stated that any conditions the Commission might impose could not contravene the FPA. The court examined the legislative history of the FPA and stated that "[i]f Congress had intended that utilities could inadvertently bootstrap themselves into common-carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling * * *." [205]

However, the D.C. Circuit in no way indicated that the Commission was foreclosed from ordering transmission as a remedy for undue discrimination. Richmond also had argued that the alleged refusal of the American Electric Power Company (AEP) and its affiliate, Indiana & Michigan Electric Company (Indiana), to wheel Richmond's excess energy was unlawful discrimination because AEP and Indiana wheeled higher-priced electricity from other AEP affiliates. The court acknowledged that Richmond's claim of unlawful discrimination was theoretically valid, but found that Richmond had failed to prove its case. It noted that if

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[205] *Id.* at p. 620.

Richmond had argued that the rates were unjustifiably discriminatory, or that Indiana's failure to use its transmission capability fully or to purchase less expensive electricity for wheeling resulted in unnecessarily high rates, a different case would be before the court.[206] The case thus does not in any way limit the Commission's authority to remedy undue discrimination.

In Central Iowa Power Cooperative v. FERC, [207] the FPC[208] reviewed the terms of the Mid-Continent Area Power Pool (MAPP) Agreement under its section 205 and 206 authority. The agreement contained two membership limitations. First, the agreement established two classes of membership, with one class being entitled to more privileges than the other. Second, the agreement excluded non-generating distribution systems from pool services. The FPC found the first limitation on membership—the two-class system—to be unduly discriminatory and not reasonably related to MAPP's objectives. The FPC conditioned approval of the agreement under section 206 on the removal of the unduly discriminatory provision. The FPC found that the second limitation, the exclusion of non-generating distribution systems, was not anticompetitive and did not render the agreement inconsistent with the public interest.

On appeal, the D.C. Circuit affirmed the FPC's decision. The court found that the FPC did have authority to order changes in the scope of the MAPP agreement, *if* the agreement was unjust, unreasonable, unduly discriminatory

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206 *Id.* p. 623, nn.53 and 57.

207 606 F.2d 1156 (D.C. Cir. 1979).

208 While *Central Iowa* was pending, certain of the functions of the FPC were transferred to the FERC under the DOE Organization Act. Accordingly, the FERC was substituted for the FPC as the respondent in the case.

or preferential under section 206 of the FPA. The court stated:

The Commission had authority, * * * under section 206 of the Act, * * * to order changes in the limited scope of the Agreement, including the addition of pool services, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract [that was] unjust, unreasonable, unduly discriminatory or preferential."[209] However, the court agreed with the FPC's conclusion that the limited scope of MAPP was not unjust, unreasonable, or unduly discriminatory. The court recognized that a pool was not invalid under section 206 merely because a more comprehensive arrangement was possible.

The D.C. Circuit upheld the Commission's refusal to eliminate the second limitation on membership by ordering MAPP participants to wheel to non-generating electric systems.[210] However, neither the Commission nor the court was presented with the argument that wheeling was necessary as a remedy for undue discrimination.

In Florida Power & Light Company v. FERC (Florida),[211] the Commission ordered Florida Power & Light Company (FP&L) to file a tariff setting forth FP&L's policy relating to the availability

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of transmission service.[212] FP&L objected to including such a policy statement in its tariff and argued that the filing of such

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209 606 F.2d at p. 1168.

210 *Id.* at p. 1169; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

211 660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983).

212 FP&L provided transmission service when four conditions were met: (1) the specific potential seller and buyer were contractually

a policy would convert FP&L into a common carrier by obligating it to offer service to all customers.[213] There was no finding that the action ordered was necessary to remedy undue discrimination.

The Fifth Circuit Court of Appeals agreed with FP&L that the mandatory filing of the policy statement would require FP&L to provide transmission service beyond its voluntary commitment because such a requirement would change its duties and liabilities.[214] The Commission order would impose common carrier status on FP&L, the court found.[215] The court noted that the Commission did not rely on a finding of anticompetitive behavior and therefore the court did not address the Commission's power to remedy antitrust violations.[216]

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identified; (2) the magnitude, time and duration of the transaction were specified prior to the commencement of the transmission; (3) it could be determined that the transmission capacity would be available for the term of the contract; and (4) the rate was sufficient to cover FP&L's costs.

213 All utilities requesting wheeling services, subject to availability, would be entitled to receive transmission service under the filed terms. Any changes to a filed rate must be filed with the Commission. This is the so-called "filed rate doctrine." *See Northwestern Public Service Company v. Montana-Dakota Utilities Company*, 181 F.2d 19, 22 (8th Cir. 1980), aff'd, 341 U.S. 246 (1951).

214 Under the filed rate doctrine, a refusal to wheel would be unduly discriminatory under section 206 of the FPA. As the court acknowledged, a customer refused service could petition the Commission to find that FP&L's policy of availability was unduly discriminatory under section 206(a) of the FPA. The court said that in the absence of a tariff on file, a utility refused wheeling services would be unable to claim discrimination under section 206(a) of the FPA. 660 F.2d at p. 675 (expressing "serious doubts that such a petition would be successful in the absence of a tariff").

215 *Id.* at p. 676.

216 *Id.* at p. 678.

The *AGD* court explicitly rejected the claim that the above line of cases establishes that the Commission lacks authority to require non-discriminatory open access.[217] Opponents of the Commission's order argued in *AGD* that *Richmond* and *Florida, supra*, stand for the proposition that the Commission cannot indirectly do what it allegedly cannot do directly, that is, impose common carriage. The *AGD* court rejected these arguments, stating that the petitioners read the electric cases far too broadly:

> [n]either *Richmond* nor *Florida* comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances.[218]

The court noted that the *Florida* case had expressly left open the question of whether the Commission would be entitled to use an open access condition as a remedy for anticompetitive conduct, and that in *Richmond* the D.C. Circuit had said little more than that unwillingness to transmit for all could not be automatically deemed undue discrimination. The court also noted the *Central Iowa* case, *supra*, in which it had upheld a Commission order that found a power pooling agreement discriminatory on its face because the agreement gave one class of membership privileged status over another. The court stated that the *Central Iowa* case "upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users."[219] The court added that it refused to "turn statutory construction upside down" by letting Congress'

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[217] The *AGD* court did not address *New York State Electric & Gas Corporation v. FERC*, 638 F.2d 388 (2d Cir. 1980), *cert. denied*, 454 U.S. 821 (1981) (*NYSEG*), presumably because that case did not concern whether the Commission could order wheeling as a remedy for undue discrimination.

[218] 824 F.2d at p. 999.

[219] 824 F.2d at p. 999.

failure to grant a general power of common carriage prevail over the affirmative grant of the specific power to eradicate undue discrimination.[220]

We conclude that *AGD*'s analysis of undue discrimination under sections 4 and 5 of the Natural Gas Act is equally applicable to an undue discrimination analysis under sections 205 and 206 of the

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FPA. The Commission and courts have long recognized that the NGA was patterned after the FPA and that the two statutes should be interpreted in the same manner.[221] Thus, we conclude that we have the authority to remedy undue discrimination and anticompetitive effects by requiring all public utilities that own, control or operate transmission facilities to file non-discriminatory open access transmission tariffs.

b Section 211 of the Federal Power Act

In concluding that we must invoke our section 206 authority to remedy undue discrimination and anticompetitive effects in the electric industry, we have carefully considered the goals of Title VII of the Energy Policy Act, and whether section 211 of the FPA, by itself, is sufficient to remedy undue discrimination in public utility transmission services. Title VII of the Energy Policy Act, which amended section 211 of the FPA to give the Commission broader authority to order wheeling in the public interest on a case-by-case basis, reflects the intent of

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220 *Id.* at p. 1006.

221 *See, e.g., FPC v. Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 n.7 (1981); and *Kentucky Utilities Company v. FERC*, 760 F.2d 1321, 1325 n.6 (D.C. Cir. 1985). Section 206 of the FPA was recently revised and now differs from section 5 of the NGA, but not in a manner significant to our discussion here. See 16 U.S.C. §§824e (b) and (c).

Congress to encourage competitive wholesale electric markets. Section 211 provides a means for wholesale power sellers and buyers to obtain transmission service necessary to compete in, or to reach, competitive markets, and is a valuable tool to encourage competitive markets. However, in amending section 211, Congress left unaltered the authorities and obligations of the Commission under sections 205 and 206 (similar to our authorities and obligations under sections 4 and 5 of the NGA) to remedy undue discrimination. In addition, as discussed below, reliance on section 211 alone in some circumstances can result in the perpetuation of, rather than the elimination of, undue discrimination and anticompetitive effects.

First, there are inherent delays in the procedures for obtaining service under section 211. However, for competitive reasons, many transactions must be negotiated relatively quickly. Many competitive opportunities will be lost by the time the Commission can issue a final order under section 211. Case-by-case section 211 proceedings are not a substitute for tariffs of general applicability that permit timely, non-discriminatory access on request.

Second, discrimination is inherent in the current industry environment in which some customers and sellers are served by open access systems, and others have to rely on negotiated bilateral arrangements or the mandatory section 211 process. The end result is discrimination in the ability to obtain transmission services, as well as in the quality and prices of the services. This national patchwork of open and closed transmission systems, with disparate terms and conditions of service, cannot be cured effectively through section 211.

The Commission believes that its actions under sections 205 and 206 will complement the section 211 procedures to achieve both the Energy Policy Act's goals of creating more competitive bulk power markets and lower rates for consumers and the Federal Power Act's explicit direction in section 205(b) that no public utility shall, with respect to any

transmission in interstate commerce, grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage.

2. Response to Commenters Opposing Our Legal Authority

a. Authority to Order Open Access Tariffs

Comments

Initial Comments Supporting Commission Authority

A number of commenters support or state that they do not oppose the Commission's authority to order open access tariffs.[222] NIEP and CCEM explain that the AGD decision supports the Commission's action in this proceeding. ELCON asserts that the Commission's "extensive treatment of the relevant case law demonstrating FERC's authority to remedy this discrimination is legally sound." UtiliCorp argues that section 211 supports, rather than undermines, the Commission's

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authority for the NOPR because it reflects Congress's intention to encourage more competitive bulk power markets.

Initial Comments Opposing Commission Authority

Other commenters assert that the Commission has improperly relied on sections 205 and 206 of the FPA to require open access.[223] They argue, for instance, that *Otter Tail* should be read as a broad constraint on the Commission's authority to order wheeling for any purpose and that the *AGD* decision does not undermine that holding

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[222] NIEP, ELCON, CINergy, UtiliCorp, TAPS, SBA, Entergy, NY Energy Buyers, Sierra.

[223] *E.g.*, EEI, Atlantic City, Allegheny, VA Com, PA Com, Ohio Edison, Southern, Utilities For Improved Transition, Dayton P&L, SCE&G, Centerior, BG&E, Central Hudson, NY Com, Salt River, Carolina P&L, Union Electric, VEPCO, Utility Workers Union.

or the cases following *Otter Tail.*[224] In support, some of these commenters discuss *Richmond Power & Light, New York State Electric & Gas Corporation*, and *Florida Power & Light Company*, the same cases discussed by the Commission in the NOPR.[225]

For example, EEI highlights the *AGD* court's discussion noting the difference between the legislative history of the NGA and that of the FPA, which the court stated was not as strong as that of the NGA. Moreover, EEI argues that the court found that section 7 of the NGA provided support for the Commission's actions in Order No. 436 and that such section 7 conditioning authority is lacking under the FPA. Allegheny notes that *AGD* did not overrule *Otter Tail.* Dayton P&L states that, in the gas case, the Commission was responding to voluntary filings by pipelines. It also says that before the NOPR, the Commission itself saw its authority as more limited. SCE&G points to differences between Commission jurisdiction over public utilities and gas pipelines and criticizes the Commission's alleged assumption that the circumstances involved in the gas and electric industries are virtually identical.

PA Com argues that the attempt to analogize to the NGA and the cases that refer to that Act is inconsistent with the technical and engineering realities of the electric transmission grid and that extensive comparisons between the natural gas industry and the electric industry are misleading.[226]

FL Com argues that, in relying on sections 205 and 206 to establish generic open access transmission tariffs for all

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[224] EEI, VA Com, Union Electric

[225] *E.g.*, EEI, VA Com, NY Com, PA Com, Salt River, Southern, Dayton P&L, Detroit Edison, BG&E.

[226] *See also* NY Com (NGA has no parallel provision to section 211 of the FPA), Salt River.

public utilities, the Commission violates the court's decision in *Cajun Electric Power Cooperative v. FERC* , 28 F.3d 173 at 179 (D.C. Cir. 1994), where, FL Com argues, the court refused to allow the Commission to use a non-evidentiary ruling when there were material facts at issue.

Reply Comments

CCEM responds that EEI and others confuse the obligations of a common carrier with the duty of public utilities not to unduly discriminate. It says that *AGD* supports the Commission's authority because the legislative history of the FPA and the NGA are similar with respect to common carriage. According to CCEM, early versions of both statutes would have made the regulated industries operate as common carriers (citing *Otter Tail*, the legislative history of the FPA, the legislative history of the Public Utility Holding Company Act, and the legislative history of the Mineral Leasing Act), but that Congress chose not to impose the common carrier obligations.

CCEM also says that the duties the Commission imposed on the gas industry and those in the NOPR are not common carriage in any event. According to CCEM, a common carrier must carry all goods offered (citing *Am. Trucking Assoc. v. Atchison, T. & S.F. Ry. Co.*, 387 U.S. 397, 406 (1967)). Finally, CCEM cites *Stephenson v. Binford*, 287 U.S. 251, 265-66 (1932), where the Supreme Court held that obligations that are typical of common carriers can be imposed on contract motor carriers.

CCEM further disagrees with EEI's argument that the enactment of section 211 was a disavowal of any other Commission authority to order transmission.

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ELCON also disagrees with EEI's claim that the Energy Policy Act undermines the Commission's pre-existing section 205 and 206 authority. It states that the savings clause

in section 212(e) of the FPA, as amended, explicitly expresses Congress' intention not to undermine the Commission's pre-existing authority and that the legislative history contains nothing to suggest otherwise.

Similarly, in response to those who argue that section 211 is the only source of authority for the Commission to order transmission, NIEP argues that sections 211 and 212 serve purposes different from section 206. It says that the Commission's authority to order transmission in the "public interest" under sections 211 and 212 is not synonymous with its authority to order transmission as a remedy for undue discrimination under section 206; the two standards are complementary but distinct:

Although broadly applicable, the Commission's ability to order wheeling under sections 211 and 212 is carefully limited by a number of procedural provisions. Foremost among these is the requirement that the wheeling may be ordered only upon a specific application for transmission services. FERC's authority to act in the public interest is thus confined to the individual case.

By contrast, FERC's remedial powers under Section 206 can be exercised upon a finding of unjust, unreasonable or unduly discriminatory or preferential practices. Once that finding has been made, however, the form and substance of the remedy is left entirely to the FERC's discretion. If FERC deems it necessary, FERC may adopt generally applicable rules or practices as a countermeasure to discriminatory acts, including ordering utilities to file generally applicable transmission tariffs.[227]

NIEP also points out that the legislative history does not address the Commission's authority to order transmission as a remedy for undue discrimination. It challenges the

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[227] NIEP Reply Comments at p.8.

interpretation of the legislative history advanced by some commenters.[228]

Next, NIEP defends the Commission's proposed findings that there is generally undue discrimination in the provision of transmission service. It notes that when an agency acts on an industry-wide basis, the agency does not have to make a finding as to each particular case.

Finally, NIEP responds to those who argue that *AGD* is not on point. It notes that the *AGD* court discussed electric cases and emphasizes the court's statement that the NGA "fairly bristles with concern for undue discrimination"—a statement that is equally true of the FPA.

TDU Systems responds to the argument that *Otter Tail* is a broad constraint on the Commission's authority to order transmission.[229] At issue in that case, it argues, was the reach of the Sherman Act, not of FPA sections 205 and 206. Similarly, it argues, the *Florida Power* case is not on point, and the court there specifically said that it was not deciding whether the Commission could have ordered wheeling as a

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228 NIEP explains that

> "[w]hile much has been made of the Senate report accompanying S.2114, which subsequently became part of PURPA in 1978, that report does not illustrate an intent to limit FERC's authority to remedy undue discrimination under section 206. That report characterizes the Supreme Court's decision in *Otter Tail* as holding that "the Federal Power Act leaves open a gap in its failure to assign the FPC general authority to order wheeling *in this situation* * * *." The "situation" to which the Report refers is not discrimination, however. Instead, the statement appears to make reference to circumstances in which general public interest concerns, such as reliability, efficiency and competition, are at stake. Thus, Senate Report 2114 is simply not a limitation on the Commission's remedial powers under Sections 206."
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> NIEP Reply Comments at p.8-9 (citations omitted).

229 *See also* Entergy.

remedy for anticompetitive activities. Moreover, TDU Systems asserts that EEI's use of a quote from a single Senator should carry no weight, since it is a well-established principle of statutory construction that such statements have little value. Finally, it points out that the *AGD* court itself did not view *Otter Tail* or other electric precedent as forbidding the Commission to order wheeling as a remedy for undue discrimination.

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Entergy asserts that Congress's refusal to require utilities to provide transmission as common carriers or whenever it is in the public interest was merely a decision not to give the Commission general authority to order wheeling, without regard to undue discrimination. Thus, the *Otter Tail* language concerning the absence of a common carrier requirement does not demonstrate that Congress meant to limit the Commission's authority to remedy undue discrimination.

ELCON disputes EEI's reading of NYSEG, noting that the NYSEG court explicitly stated:

> Nor do we suggest that the Commission is powerless to review a wheeling agreement under section 206 without following the requirements of sections 211 and 212.[230]

TAPS discusses numerous cases, including the primary cases relied upon by the Commission, and disposes of *NYSEG* by stating that it is no longer good law, if it ever was.

Commission Conclusion

There can be no question that the Commission has the authority to remedy undue discrimination. Sections 205 and 206 of the FPA mandate that we ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public

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[230] ELCON Initial Comments at p. 7 (quoting NYSEG at p. 403).

utility, no person is subject to any undue prejudice or disadvantage. Under these sections, we must determine whether *any* rule, regulation, practice, or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and we must disapprove those contracts and practices that do not meet this standard. Our discretion is at its zenith in fashioning remedies for undue discrimination.[231]

Some commenters, however, challenge our authority to order industry-wide non-discriminatory open access as a remedy for the undue discrimination we have found in the industry. As summarized above, they essentially assert that we are prohibited by court precedent, the legislative history of the FPA, and sections 211 and 212 of the FPA from ordering wheeling as a remedy for undue discrimination. We disagree and conclude that we have the authority—indeed, a responsibility—to require non-discriminatory open access transmission as a remedy for undue discrimination.

AGD and Legislative History

The court decision in *Associated Gas Distributors v. FERC* provides powerful support for our ability to order industry-wide non-discriminatory open access transmission in the electric industry as a remedy for undue discrimination. As discussed in detail above, *AGD*, which is the only decision to have addressed the Commission's authority to remedy undue discrimination by requiring open access, upheld our authority under section 5 of the NGA (the parallel to section 206 of the FPA) to require open access in the natural gas industry. The rationale supplied by the *AGD* court applies equally to the FPA and our responsibility to eliminate undue discrimination in the electric industry.

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231 *See, e.g.*, Niagara Mohawk *Power Corporation v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

Those who challenge the Commission's legal authority to remedy undue discrimination face the same difficulty that parties faced in seeking to overturn open access in the natural gas industry—they "can point to no language in the [FPA] barring the Commission from imposing common carrier status on [public utilities], and certainly none barring it from imposing upon the [public utilities] a specific duty that happens to be a typical or even core component of such status."[232] Instead, as was unsuccessfully attempted in the *AGD* proceeding, they seek to overcome the statutory silence primarily by means of legislative history. However, as the *AGD* court explained, legislative history is not even relevant, because

> courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point.[[233]] Here, as the court found with respect to the NGA, the legislative history of the FPA "provides strong support only for the point that Congress declined *itself to impose common carrier status on [public utilities]* * * * *It affords weak—*

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> almost invisible—support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[234]

Commenters focus on the following statement in the *AGD* decision to support the argument that, because Congress did not expressly reject common carriage under the

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232 *AGD*, 824 F.2d at p. 997.

233 *Id.* (quoting *IBEW, Local No. 474 v. NLRB*, 814 F.2d 697, 712 (D.C. Cir. 1987) (emphasis deleted by court from original)).

234 *Id.* (emphasis added).

NGA, but did reject it under the FPA, a different outcome in this proceeding is required:

> we note that the legislative history of the two acts is, on this point, materially different. In its deliberations on the bill that ultimately emerged as the Federal Power Act, Congress considered and rejected a provision that would have "empowered the Federal Power Commission to order wheeling if it found such action to be 'necessary or desirable in the public interest.' " (citing *Otter Tail*) (quoting S. 1725, 74th Cong., 1st Sess.). The evidence as to the NGA (surveyed above) is less direct: it consists exclusively of various occasions on which Congress did not adopt proposals actually making the natural gas pipelines into common carriers.[235]

The above statement, however, does not preclude the *AGD* court's decision on our broad authority to remedy undue discrimination in the gas industry from applying equally in the electric industry. Clearly, the court did not say that. As discussed below, we believe the statement focuses on a distinction in the legislative histories that is not meaningful.

First, whether or not a material difference exists in the respective legislative histories of the NGA and FPA, the fact remains that the crucial findings of the *AGD* court were that: (1) "Congress declined *itself* to impose *common carrier* status" (emphasis added) and (2) there is no "support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty."[236] These findings apply equally to

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[235] *Id.* At p. 998-99.

[236] *Id.* At p. 997. We also note that the contract carriage obligation we are imposing is easily distinguished from the common carrier obligation Congress chose not to adopt. As discussed *infra*, the common carrier provisions rejected by Congress would have required transmission for

the FPA. Simply stated, statutory silence cannot be overcome by means of legislative history—even if the legislative history in fact indicated that Congress "rejected" legislative imposition of common carrier status under the FPA, but "did not adopt" it under the NGA. In either event, nothing in the statute or legislative history suggests that Congress concluded that the Commission could under no circumstances impose open access as a remedy to undue discrimination.

Moreover, the legislative history of the bills containing the FPA and the NGA, taken as a whole, suggests that the distinction drawn in *AGD* between the legislative histories of the NGA and the FPA is not meaningful. The legislation that was to become the FPA originally included provisions regulating both electric power and natural gas. As originally proposed, the legislation contained *identical* common carriage language for both public utilities and natural gas pipelines.

With respect to the FPA, the Supreme Court explained in *Otter Tail* that

> [a]s originally conceived, Part II would have included a "common carrier" provision making it "the duty of every public utility to * * * transmit energy for any person upon reasonable request * * *." In addition, it would have empowered the Federal Power Commission to order wheeling if it found such action to be "necessary or desirable in the public interest." H.R. 5423, 74th Cong., 1st Sess.; S. 1725, 74th Cong. 1st Sess. These provisions were eliminated to preserve "the voluntary action of the utilities." S.Rep. No. 621,

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"any person" upon reasonable request. This would have included retail purchasers.

74th Cong., 1st Sess., 19.[237]

The language paraphrased by the Supreme Court was from Title II of the initial bill proposing the Public Utility Holding Company Act. The entire sections from which the paraphrased language came are as follows:

> SEC. 202. (a) It shall be *the duty of every public utility* to furnish energy to, exchange energy with, and *transmit energy for any person upon reasonable request* therefor; and to furnish and maintain such services and facilities as
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> shall promote the safety, comfort, and convenience of all its customers, employees, and the public, and shall be in all respects adequate, efficient, and reasonable.
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> * * *
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> SEC. 203. (b) Whenever the Commission after notice and opportunity for hearing finds such action *necessary or desirable in the public interest*, it may by order direct a public utility to make additions, extensions, repairs, or improvements to or changes in its facilities, to establish physical connection with the facilities of one or more other persons, to permit the use of its facilities by one or more other persons, or to utilize the facilities of, sell energy to, purchase energy from, transmit energy for, or exchange energy with, one or more other persons. Where any such order affects two or more persons, the Commission may prescribe the terms and conditions of the arrangement to be made between such persons, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them.[238]

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237 *Otter Tail*, 410 U.S. at p. 374.

238 H.R. 5423, 74th Cong., 1st Sess., 32 (emphasis added).

This initial bill proposing the Public Utility Holding Company Act also included a Title III that was intended to regulate the transmission and sale of natural gas. Sections 303(a) and 304 of Title III included the *identical* common carrier language paraphrased by the Supreme Court and included in sections 202(a) and 203(b) of Title II.[239] After further deliberations, Congress rejected the above-quoted language in Title II and eventually adopted a Title II that did not include any common carrier language. On the other hand, Title III (addressing regulation of natural gas) was not reported out of committee, but reemerged in the next year.[240] The bill that reemerged did not contain the common carrier language that was in the original Title III. However, as Congress had just debated the common carrier issue in enacting electric power regulation, it is not surprising that Congress did not engage in debating the very same issue in enacting natural gas regulation.

Because of the timing of the legislation involving the FPA and the NGA and the logical nexus between the two acts, we conclude that there is in fact no material difference as to this issue in the legislative histories of the two acts.

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239 *Id.* at p. 44.

240 In the debate on the subsequent bill to regulate natural gas, Congressman Cole explained:

> Mr. Chairman, the House should realize that the measure we are dealing with today is of extreme importance, more so than the attendance and the time taken in the discussion would seem to indicate. It is the culmination of one of the most far-reaching, intensive studies of the Federal Trade Commission I assume that that Commission ever conducted, and last year found a place in not identical language but very similar in the Rayburn bill, the famous holding-company bill, as part 3 thereof. Our committee eliminated part 3, as members will recall, and saved it for a separate measure reported out as it was last year, which was not considered by the House, but is here today in improved form.

81 Cong. Rec. H6724 (daily ed. July 1, 1937).

Both initially included identical common carrier language, and the language was removed from both. As to both acts, Congress chose not to impose common carrier obligations on the electric or natural gas industries, but gave the Commission the authority and responsibility to eliminate undue discrimination in both industries. Consequently, as open access was found to be a proper remedy for undue discrimination in the natural gas industry, it is also a proper remedy for undue discrimination in the electric industry.

As the *AGD* court noted with respect to the Commission's powers and duties under the NGA, Congress explicitly gave the Commission the authority to eradicate undue discrimination under the FPA. That explicit power and duty provided by Congress cannot be invalidated solely on the ground that Congress chose not to impose statutory common carrier status on public utilities or did not explicitly authorize the Commission to do so.[241] As the *AGD* court explained, this would "turn [] statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one."[242]

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Other Case Law

A number of commenters argue that the Commission misinterpreted the other cases discussed in the NOPR with respect to our authority to order non-discriminatory open access transmission. We disagree. As demonstrated above, not one of the cases put forth by commenters holds that we cannot remedy undue discrimination by requiring public

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241 *AGD*, 824 F.2d at p. 998.

242 *Id.*

utilities to provide non-discriminatory open access transmission.[243]

AGD is the *only* case in which a court specifically addressed our authority to order open access transmission as a remedy for undue discrimination. Its favorable finding with respect to our action under section 5 of the NGA directly supports our ordering non-discriminatory open access transmission under section 206 of the FPA.

Authority to Act by Rule

We disagree with those commenters that assert that we may find and remedy undue discrimination only through case-by-case adjudications and are prohibited from making a generic determination of undue discrimination through a rulemaking. First, there is no question that it is within our discretion whether we act through rule or through case-by-case adjudications.[244] The *AGD* court specifically rejected a similar argument that the Commission erred in requiring open access transportation tariffs without first finding that each individual pipeline's rates were unlawful. The *AGD* court held that "[t]he Commission is not required to make individual findings if it exercises its §5 authority by means of a generic rule."[245]

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[243] *See FERC Statutes and Regulations* at pp. 33,053-56. We further note that the *AGD* court did not discuss the *NYSEG* decision at all. Indeed, the *NYSEG case did not involve any allegations of undue discrimination and any discussion of section 206 by the court was dictum.*

[244] See, e.g., NLRB v. Bell Aerospace Company, 416 U.S. 267, 293 (1974) (*citing SEC v. Chenery Corporation*, 332 U.S. 193, 202-03 (1947)). *See also Heckler v. Campbell*, 461 U.S. 458, 467 (1983) (even where enabling statute requires a hearing to be held, agency may rely on its rulemaking authority); *Panhandle Eastern Pipeline Company v. FERC*, 907 F.2d 185, 187-88 (D.C. Cir. 1990). Under section 403 of the DOE Act, 42 U.S.C. 7173, the commission is authorized at its discretion to initiate rulemaking proceedings.

[245] *AGD*, 824 F.2d at p. 1008.

We have identified a fundamental generic problem in the electric industry: owners, controllers and operators of monopoly transmission facilities that also own power generation facilities have the incentive to engage, and have engaged, in unduly discriminatory practices in the provision of transmission services by denying to third parties transmission services that are comparable to the transmission services that they are providing, or are capable of providing, for their own power sales and purchases. These practices drive up the price of electricity and hurt consumers. Furthermore, the incentive to engage in such practices is increasing significantly as competitive pressures grow in the industry. It is within our discretion to conclude that a generic rulemaking, not case-by-case adjudications, is the most efficient approach to take to resolve the industry-wide problem facing us.

b. Undue Discrimination/Anticompetitive Effects

Initial Comments

A number of commenters allege that the Commission has failed to meet its burden of proving industry-wide discrimination.[246] They assert that the Commission has provided only a few unsubstantiated allegations of discrimination, which do not represent the current conditions in the electric industry, or that the Commission has not shown that all electric utilities have unduly discriminated. Some attack the NOPR's incorporation by reference of the unsubstantiated allegations of discrimination set forth in a petition for rulemaking filed on February 16, 1995 by the Coalition for a Competitive Electric Market (CCEM).[247]

EEI argues that the allegations of discrimination in the NOPR must be considered in light of the fact that: (1) All

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246 *E.g.* EEI, Ohio Edison, PA Com, BG&E, NY Com, Minnesota P&L, Carolina P&L.

247 *E.g.*, EEI, BG&E.

tariffs currently on file have been found by the Commission not to be discriminatory; (2) more than 30 utilities have voluntarily filed open access tariffs, which belies any assertion of widespread discrimination in the industry; and (3) transmission disputes are rare, with only 19

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section 211 proceedings having been filed in the last three years.[248] EEI concludes that the Commission's allegations of discrimination do not rise to the level of "extreme circumstances" found by the court in the natural gas industry in *AGD*.

EEI adds that the Commission's proposal to act under section 206 is itself discriminatory because it applies only to public utilities and does not reach all transmission-owning utilities.[249] If reciprocity is designed to resolve this problem, EEI believes that reciprocity should also be "effective for public utilities." Furthermore, EEI argues that the failure of a public utility to provide to others a service that it does not provide itself is not evidence of discrimination, and that inclusion of such a provision actually results in preferential treatment for transmission users.

NE Public Power District alleges that the NOPR does not contain a single reference to any actual discrimination or anticompetitive conduct by any publicly owned utility.

Salt River asserts that the Commission is required to consider all elements of an antitrust analysis before reaching a conclusion that market power exists in the transmission system and that we have failed to do so.[250] It concludes that the NOPR "constitutes an attempt to legislate a remedy for an

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248 *See also* Ohio Edison.

249 *See also* SCE&G.

250 Salt River Initial Comments at p. 5-6 (referencing an attached legal memorandum of Donald A. Kaplan).

evil that has not been, and cannot be, lawfully found to exist on a wholesale basis among utilities that own and operate integrated generation and transmission systems."[251]

PA Com argues that the Commission's request for examples of discriminatory behavior is a "tacit admission as to the paucity of evidence of discriminatory practices by transmission owning utilities." NY Com argues that the "Commission's lack of a record basis for its proposed findings is legally suspect because courts in two cases have held that the Commission cannot proceed with open access transmission tariffs absent record findings of specific anticompetitive conduct."[252]

Finally, EEI claims that even if the Commission has proven its allegations of discrimination, we have failed to meet the requirements of section 206 of the FPA.[253] According to EEI, the Commission cannot find, without an adjudicatory hearing, that the rates on file are unlawful and order replacement rates.[254] The Commission's proposed procedure would unlawfully place the burden of justifying existing rates on the utilities.

Reply Comments

A number of commenters provide instances of discriminatory behavior they have faced over the years. NCMPA describes difficulties it has faced in dealing with CP&L, including a situation where CP&L allegedly impeded

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251 Salt River Initial Comments at p. 6.

252 NY Com Initial Comments at 16-18 (discussing *FPL* and *Cajun*).

253 *See also* Southern.

254 *See also* Southern.

NCMPA's use of transmission access through CP&L's control of dispatching.[255]

AMP-Ohio alleges that Toledo Edison refused to transmit emergency power on a buy-sell basis to certain AMP-Ohio members even though Toledo Edison's system was not constrained. Instead, AMP-Ohio alleges, Toledo Edison bought the power and resold it to AMP-Ohio at a higher rate.

APPA challenges EEI's claim that there is no substantial evidence of undue discrimination in transmission. It suggests that nineteen instances of transmission disputes being filed since the Energy Policy Act was enacted is ample evidence of undue discrimination. Moreover, according to APPA, reported abuses are only the tip of the iceberg.

CCEM responds to the argument raised by EEI and others that there is no showing of extreme circumstances of discrimination in the electric industry such as the AGD court noted in the gas industry. It says that these circumstances are present and gives numerous examples; it does not identify the specific utilities because "it is the experience of * * * [our] members that nearly all transmission owners retaliate

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* * *" against anyone who complains. Moreover, in answer to EEI's statement that transmission disputes are rare, CCEM states that since most of the competition is in the short-term market, it has not been worthwhile to file complaints. The examples provided by CCEM include: (1) refusal by a California public utility to offer firm service; (2) refusal by control area utilities in Texas to offer ancillary services to a power marketer, with the result that one of the utilities won the bid, even though it did not have the lowest price; (3) non-utilities in ERCOT being unable to compete to meet short-

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255 We note that CP&L raised legal objections to our authority to implement this rule.

term requests for economy energy because they were required to schedule by noon of the preceding day, while utilities did not subject themselves to such a scheduling requirement; (4) power pool or control area information requirements, particularly in the northwest part of WSPP, that force non-utilities to reveal commercially sensitive information; the transportation operator has then revealed the information to its own or its affiliate's sales arm, which "steals" the deal; (5) a northeast power pool that refused to wheel out even though capacity was available on the grounds that sending power out of the pool would drive up prices in the pool (hoarding); (6) a power marketer that asked a utility to provide transmission, whereupon the utility bought up certain transmission capacity necessary for the marketer to reach its buyer, thus blocking the path—this was possible because the utility was able to locate the purchaser based on commercially sensitive information the marketer had to give the utility when the marketer asked for transmission; (7) a common contracting practice among utilities restricting the use of interconnections to themselves, particularly in the Southwest Power Pool, MAPP, and MAIN; (8) utilities overstating the cost of improvements (gold-plating) and thus discouraging service. CCEM also responds to each of EEI's criticisms of CCEM's examples of undue discrimination submitted in its February 16, 1995 petition and argues that its examples of undue discrimination are unrebutted.

Brownsville asserts that

> while PUB [Brownsville] must pay multiple distance-based and pancaked transmission rates to engage in transactions with the non-ERCOT universe, El Paso Electric would have *received* transmission payments from its merger partners while gaining *free* transmission access to buy and sell within ERCOT. CSW presently walls other ERCOT utilities off from participation in the Western Systems Power Pool, while its ERCOT

> subsidiaries, CPL and WTU, share in the benefits of their non-ERCOT affiliates' WSPP memberships via the preferential terms of the CSW Operating Agreement. CSW treats its own inter-affiliate central dispatch as having a higher priority than third-party economy energy transactions, with the result that CPL not infrequently crowds PUB out of the economy market.[256]

Wisconsin Municipals states that its members have been fighting transmission battles for years and sets forth five examples of the sort of difficulties it has experienced in attempting to obtain transmission rights. For example, it explains that Wisconsin public utilities have resisted an effort by the state commission to achieve comparability of use of transmission. Wisconsin Municipals also explains a situation where "if WPPI continued to purchase its power from WPSC, it would pay WPSC $843,840 annually for transmission service: if it purchases power off system from WP&L (one of WPSC's competitors), WPPI would pay WPSC $1,774,224 for transmission service to the exact same load."

TAPS sets forth additional examples of undue discrimination, including refusals to wheel even in the face of Nuclear Regulatory Commission (NRC) nuclear license conditions requiring wheeling, and Northeast Utilities' refusal to provide transmission to a QF even though it had indicated to the Commission that it would provide such transmission in order to obtain Commission approval of its proposed merger with Public Service Company of New Hampshire.

NIEP sets forth ten examples of undue discrimination that its members have experienced in seeking access to transmission service at reasonable terms and conditions.

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256 Brownsville Reply Comments at p. 2-3 (emphasis in original).

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Some commenters challenge these claims of undue discrimination. For example, Carolina P&L responds to NCMPA #1's example of obstruction by Duke in accommodating energy sales from the jointly-owned Catawba Plant. Carolina P&L explains that NCMPA #1's proposal "would require Duke to provide its own generation resources on behalf of NCMPA #1 in order to support a bulk power sale when NCMPA #1's own resource capacity and energy are not sufficient for the sale." Carolina P&L argues that this is backstanding that goes beyond the scope of any ancillary service the Commission has proposed and would be entirely inappropriate "to compel the Transmission Provider to sell power to its Transmission Customer for resale on the bulk power market."

Duke also responds to NCMPA #1's claim of discrimination and asserts that NCMPA #1's claim is not relevant to the NOPR proceeding, but is a specific contractual claim that should be pursued pursuant to the terms of its contract.

Commission Conclusion

We conclude that unduly discriminatory and anticompetitive practices exist today in the electric industry and, more importantly, that such practices will increase as competitive pressures continue to grow in the industry, unless the Commission acts now to prevent such practices.[257] It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide themselves.

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257 While many public utilities have filed some form of open access tariff (often in response to our proposed rule), we believe that many of the remaining utilities will not voluntarily open their systems absent a final rule. *See also* note 266.

The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices. As the *AGD* court stated: "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[258]

We set forth examples in the NOPR of undue discrimination that we believe are occurring in the electric industry and invited commenters to identify any discrimination that they may have experienced. In response, commenters presented numerous additional examples of undue discrimination, which are summarized above, and we set forth below further examples of undue discrimination that have been raised in cases before the Commission.

Many of the examples of discriminatory behavior that have been brought to our attention do not name the specific utilities involved, and many are allegations that are not proven. However, we do not believe that this undermines our finding of unduly discriminatory practices by transmission owners and controllers. We believe that it is only natural that potential transmission customers with an interest in participating in electric markets will be reluctant to name names for fear of being shut out of those markets. CCEM, which identified a wide array of discriminatory behavior its members have experienced, explained that

> [w]e do not identify the specific utilities in each example because it is the experience of CCEM members that nearly all transmission owners retaliate by cutting off all communications with anyone that challenges or complains about the rates, terms or conditions at which the owner offers access

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[258] *AGD*, 824 F.2d at p. 1008.

> to its system. Inasmuch as most of the competitive commerce in electric power today is in short-term markets, it is typically not worth the effort of CCEM members or other transmission-dependent entities to file a complaint with the Commission's enforcement staff or in the courts in connection with a transmission owner's discriminatory practices. The deal is lost well before a complaint can be processed and ruled upon.[259]

Other examples of discriminatory behavior have also been raised in proceedings before the Commission. As we

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explained in detail in the NOPR, transmission-owning utilities have discriminated against others seeking transmission access in a variety of ways, most often subtly and indirectly.[260] For example, delaying tactics have been used to frustrate access. The history of Pacific Gas and Electric Company's (PG&E) attempt to avoid its commitments made to the California owners of the California-Oregon Transmission Project (COTP) is a prime example. The owners had originally planned the COTP to have its southern terminus at the Midway station with Southern California Edison. PG&E convinced them to terminate the project instead at PG&E's Tesla station and indicated that PG&E would provide transmission service the rest of the way south to Midway. PG&E promised this service in 1989 (in Principles). PG&E spent the next four years filing substitute provisions for what it had promised in the Principles.[261] Additional allegations of discriminatory

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259 CCEM Initial Comments at p. 18-19. See also NIEP Reply Comments at p. 13 n.31.

260 *FERC Statutes and Regulations* at p. 33,072.

261 *See Pacific Gas and Electric Company*, 65 FERC ¶61,312, at p. 62,428-30 and n.22, *remanded on other grounds, Pacific Gas & Electric*

behavior are set forth in Appendix C, which includes allegations made under oath in proceedings at the Commission and allegations made in pleadings and other documents before the Commission.

In addition, to date, the Commission has received 28 section 211 transmission requests.[262] Applicants submit section 211 transmission requests when the transmission provider refuses to provide the requested transmission service. For example, American Municipal Power-Ohio, Inc. (AMP-Ohio) requested Ohio Edison Company (Ohio Edison) to establish additional delivery points to certain of AMP-Ohio's members and to permit the addition of delivery points in the future upon AMP-Ohio's request. Ohio Edison refused AMP-Ohio's request, claiming that it was not a proper request under section 211 because it already provided wholesale transmission to the municipal utilities at issue. In a proposed order, the Commission disagreed with Ohio Edison and ordered Ohio Edison to provide the requested additional delivery points and to entertain future requests by AMP-Ohio for specific delivery points.[263]

Many of the examples of discriminatory actions we are seeing in the electric industry are similar to those we saw in the gas industry. Given our experience, we find that these examples of discriminatory actions are credible and well-founded. Thus, we conclude that there is more than sufficient reason to believe that transmission monopolists currently engage in unduly discriminatory practices, and that they will continue to engage in unduly discriminatory practices, unless we fashion a remedy to eliminate their ability and incentive

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Company v. FERC, No. 94-70037 (9th Cir. June 23, 1994) (unpublished opinion), *order on remand*, 69 FERC ¶61,006 (1994).

[262] A list of section 211 applications and the status of each is attached as Appendix A.

[263] *American Municipal Power-Ohio, Inc. v. Ohio Edison Company*, 74 FERC ¶61,086 (1996).

to do so. In light of the competitive changes occurring in today's electric industry, we believe that the only effective remedy is non-discriminatory open access transmission, including functional unbundling and OASIS requirements, and that it is within our statutory authority to order that remedy.

Further, we disagree with the argument that we are limited to applying a traditional antitrust analysis in determining whether market power exists in the transmission system. While we must take antitrust concerns into consideration in exercising our responsibilities under the FPA, we are not an antitrust court, and our responsibilities are not those of the Department of Justice.[264] We have analyzed the incentives and practices of monopoly transmission owners and controllers in light of the statutory standards and directives of the FPA and, based on our findings, have properly concluded that there is a generic problem that must be remedied.

The Commission also recognizes, as some commenters suggest, that we have, in the past, permitted utilities to file tariffs containing restrictions on transmission

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service that we are now finding to be unduly discriminatory in this rule and that we found unduly discriminatory in cases since our decision in *AEP*. However, it is entirely appropriate, and indeed necessary, that our application of the FPA's undue discrimination standard evolve over time and adapt to the changing circumstances in the industry. Our prior willingness to tolerate the use of monopoly power over transmission to maintain and aggregate the utility's market

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[264] See, e.g., Gulf States Utilities Company v. FPC, 411 U.S. 747, 758-60 (1973); *FPC v. Conway Corporation*, 426 U.S. 271, 279 (1976); *Northern Natural Gas Company v. FPC*, 399 F.2d 953, 960 (D.C. Cir. 1968).

power over generation occurred in the context of an industry structured largely as vertically integrated regulated monopolies that supplied all facets of utility service—power supply, transmission, and distribution—as a single monopoly service. Competition generally was not meaningfully available as a means to discipline prices and consumer interests were best served by improving efficiencies of the integrated utilities, subject to cost-based regulation.

Today, the circumstances of the industry are radically different. As explained in detail in Section III, a series of significant economic, regulatory, and technical changes in the power industry has introduced the promise of competitively priced power supplies. The profile of electric power suppliers has expanded to include not just the power supply arms of traditional utilities, but also independent power suppliers, affiliated utility power suppliers selling into territories of other franchise utilities, and power marketers.[265] This offers the promise of an increasingly competitive commodity market in electric power, in which significant benefits to consumers can be achieved. In the context of an emerging competitive market in generation, discriminatory practices that once did not constitute *undue* discrimination must be reviewed to determine whether they are being used to prevent the benefits of competition in generation from being achieved. Here we find conclusively that they are, and use our remedial authority to ensure that they can no longer occur.[266]

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[265] We note that there are now 14 power marketers that are affiliated with public utilities.

[266] We take note of EEI's comments that, at the time of the comments, 30 utilities had filed open access tariffs. They argue, therefore, that the rule is unnecessary. Since their comment was filed, the number of utilities filing some form of an open access tariff has risen to 106. However, while some of these tariffs are based on the NOPR pro forma tariffs, many of these tariffs fall significantly short of the tariff requirements of both the NOPR and this Rule. Even if the tariffs met

c. Section 211

Comments

Various commenters contend that the enactment of section 211 in essence either removed any authority the Commission might have had under sections 205 and 206 or demonstrates that Congress did not believe the Commission could order wheeling under those provisions.

These commenters assert that the legislative history of the FPA indicates that Congress specifically rejected giving the Commission authority to order wheeling under any circumstances.[267] They further contend that the legislative history of section 211 demonstrates that Congress viewed the authority it granted in section 211 as a strictly limited and entirely new authority for the Commission.[268] Specifically, EEI states that the legislative history of the Energy Policy Act confirms that the expanded authority provided under section 211 was not intended to grant the Commission blanket authority to order wheeling, even as a remedy for anticompetitive conduct. Similarly, Utilities For Improved Transition argues that the legislative history shows that Congress specifically intended to preclude the Commission from ordering tariffs of general applicability under any circumstances. In addition, EEI points to testimony provided

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these requirements, the Rule is still needed to complete the task of eliminating undue discrimination by all public utilities and assuring, to the extent possible, a nationwide open access transmission grid. Indeed, a number of these tariffs were filed for the purposes of securing authority to market power *competitively*. This underscores markedly our fundamental conclusion that prior practices of using monopoly power over transmission to preserve market power over electricity sales has no place in today's industry and must be eliminated to get the benefits of competition to the customers we are required to protect under the FPA.

267 E.g., EEI, VA Com, Ohio Edison Southern, Utilities For Improved Transition, BG&E.

268 *See also* NM Com.

by a Commission staff witness before the Subcommittee on Energy and Power of the House Committee

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on Energy and Commerce in which EEI claims that "she suggested that an affirmative statement that the Commission had the power to require wheeling on its own motion should be included, possibly in section 211." EEI maintains that such suggestion was rejected by Congress in favor of allowing the Commission to order wheeling only upon application.

Detroit Edison, asserting that Cajun stands for the proposition that the agency must follow Congressionally mandated procedures, claims that the Commission can order transmission only after going through the procedures of section 211. Detroit Edison also argues that the Commission should incorporate into the final rule the various safeguards of section 211, such as the requirement that the utility receive prior notice, the requirement that transmission service be in the public interest, and the requirement that existing service not be displaced. FL Com further asserts that it was Congressional intent in the Energy Policy Act for wheeling to be ordered on a case-by-case basis pursuant to section 211.[269]

EEI argues that the enactment of section 211 eliminated any authority the Commission had under sections 205 and 206 to order wheeling as a remedy for undue discrimination. It alleges that the Commission failed to discuss the NYSEG case concerning the relationship between section 211 and sections 205 and 206 in any meaningful way. According to

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[269] *See also* Salt River. Moreover, FL Com states that the Commission should modify its hearing process to better accommodate state PUC participation by: (1) Holding hearings in the affected state; (2) teleconferencing; (3) making free transcripts available to states; and (4) substantially deferring to a state when the state commission has held a hearing on an issue in the case.

EEI, the NYSEG court concluded that section 211 "was the only appropriate vehicle under which the Commission could order NYSEG to wheel power for the municipality."[270] EEI further resorts to canons of statutory construction to conclude that "section 211 must be given effect as the more specific provision and must be interpreted to limit the scope of sections 205 and 206."[271] In addition, EEI asserts that "Congress had an opportunity to reject the NYSEG court's interpretation of the scope of sections 205, 206 and 211, but instead amended section 211 in a manner that is consistent with the view that mandatory wheeling is to be governed exclusively by section 211." Dayton P&L raises similar arguments. It notes the savings provision in section 212(e), but says that Congress "would have been more specific if it understood that the Commission already had the authority to order wheeling under FPA sections 205 and 206. * * *"[272]

Associated EC argues that the NOPR appears to exceed the Commission's authority in that it proposes that "wholesale *buyers* and sellers have 'equal access to the transmission grid.' " It asserts that "Section 211(a), however, makes mandatory transmission service available only to

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270 EEI quoted the following language from NYSEG:

> Nor do we suggest that the Commission is powerless to review a wheeling agreement under section 206 without following the requirements of sections 211 and 212. If, after a hearing as required by section 205, the Commission determines that a particular rate, charge or condition is unreasonable, it can order a modification. But where, as here, the modification amounts to an order requiring wheeling, it must be preceded also by determination in accordance with sections 211 and 212. Simply put, we will not allow the commission to do indirectly without compliance with the statutory prerequisites, what it could not do directly without such compliance (*citing Richmond Power & Light*).

271 *See also* VA Com.

272 *See also* Carolina P&L.

'[a]ny electric utility, Federal power marketing agency or any other person generating electric energy for sale for resale.' »[273]

NE Public Power District argues that sections 211 and 212 of the FPA appear clearly to contemplate a case-by-case approach.[274] NE Public Power District adds that if the Commission believes sections

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211 and 212 are inconsistent with the public interest, it can ask Congress to modify those provisions. Allegheny adds that the Commission can order wheeling only under sections 211 and 212 on a company-specific basis and can use sections 205 and 206 only to evaluate the reasonableness of terms and conditions of voluntarily filed agreements or tariffs by public utilities.

Utilities For Improved Transition also claims that sections 211 and 212 override any authority the Commission might have had under sections 205 and 206 to order industry-wide open access. It cites the savings clause in section 212(e) of the FPA as limiting the Commission's authority to order transmission.[275] Utilities For Improved Transition argues at

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[273] This argument is puzzling. First, Section 211 does not control to whom access must be provided under sections 205 and 206. However, even if it did, Associated EC appears to misconstrue eligibility under section 211. An electric utility as defined in the FPA is any person or State agency (including any municipality) which sells electric energy. The definition does not say that electric energy must be re-sold at wholesale. Thus, an electric utility could be a wholesale *buyer* of transmission used to transmit energy for sale at either wholesale or retail.

[274] *See also* Allegheny.

[275] It states that:

> Section 212(e), however, provides that Sections 211 and 212 limit or impair the Commission's authority under "other provisions of law" (a phrase including, obviously, Sections 205 and 206). On the face of the statute—we say again for

some length that the NOPR does not meet the procedural and substantive standards of sections 211 and 212. It goes on to cite various passages from the legislative history of the Energy Policy Act as supporting the view that Congress intended to eliminate the Commission's authority to order industry-wide open access as a remedy for undue discrimination. According to Utilities For Improved Transition, these passages "unmistakably show a clear legislative intent to preclude the mandatory transmission that the Commission attempts here * * *."

Commission Conclusion

We disagree with those commenters that argue that the Energy Policy Act either eliminates our authority under section 206 to remedy undue discrimination by requiring non-discriminatory open access transmission or demonstrates that we never had any such authority. Nothing in sections 211 and 212 or in the legislative history of these sections indicates that Congress intended to eliminate the Commission's other, broader authorities under the FPA. Indeed, section 212(e) specifically provides:

> SAVINGS PROVISIONS.—(1) No provision of section 210, 211, 214, or this section shall be treated as requiring any person to utilize the authority of any such section in lieu of any other authority of law. Except as provided in section 210, 211, 214, or this section, *such sections shall not be construed as limiting or impairing any authority of the Commission under any other provision of law.*[276]

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emphasis: *on the face of the statute*—the Commission therefore does not have the authority to order transmission services outside the provisions of Sections 211 and 212."

Utilities For Improved Transition Initial Comments at p. 51 (emphasis in original).

276 16 U.S.C. §824k (emphasis added).

Utilities For Improved Transition's argument that the "Except as provided" clause limits or impairs the Commission's authority to order transmission service under sections 205 and 206 would make the savings provision meaningless. Moreover, such a reading would be entirely at odds with the underlying purposes of the Energy Policy Act. It would be ironic indeed to interpret the Energy Policy Act as eliminating our long-standing, broad authority to remedy undue discrimination, given the pro-competitive purpose of the statute.

The legislative history also provides no support for the arguments that sections 211 and 212 remove or prove the non-existence of the Commission's authority to remedy undue discrimination by requiring non-discriminatory open access transmission. In fact, virtually every bit of legislative history raised by commenters opposing the NOPR consists of various statements by Senator Wallop, an opponent of expanding transmission access under sections 211 and 212.[277] Such legislative history provides no insight into

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the meaning of a statute and is given little or no weight by the courts.[278]

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[277] In discussing the electricity provisions of the Energy Policy Act, Senator Wallop declared:

> It would be a mistake to take the presence of transmission access provisions in the Conference Report as a sign of change in position on my part or that of the Senate. I would have strongly preferred PUHCA reform without any transmission access provisions, as was the Senate position. However, in order to obtain the very significant benefits of PUHCA reform contained in the Senate bill, it was necessary to accept some of the House transmission access provisions.

138 Cong. Rec. S17615 (daily ed. October 8, 1992)

[278] See, e.g., Shell Oil Company v. Iowa Department of Revenue, 488 U.S. 19, 29 (1988) (*Shell*). In *Shell*, the Court declared:

The only other legislative history that commenters put forth is the testimony of a Commission staff witness, in 1992 hearings before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce. According to EEI, the witness indicated that an affirmative statement that the Commission could require wheeling on its own motion "would be needed [in the Energy Policy Act] if Congress intends for the Commission to be able to deal with transmission on its own motion and thereby go further than simply dealing with industry proposals." EEI claims that this statement demonstrates that the expanded authority in the Energy Policy Act "was not intended to grant the Commission blanket authority to order wheeling, even as a remedy for anticompetitive conduct."

EEI's argument is misleading and disingenuous. It takes the witness's statements out of context, ignoring attendant testimony that "there are strong legal arguments that the Commission's obligation to protect against undue discrimination carries with it the authority to impose transmission requirements as a remedy for undue preference or discrimination," and the extensive legal argument, included in her testimony, in favor of that position—an argument that closely parallels the legal argument the Commission is relying on in this proceeding.[279] Indeed, in the

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This Court does not usually accord much weight to the statements of bill's opponents. "[T]he fears and doubts of the opposition are no authoritative guide to the construction of legislation." *Gulf Offshore Co. v. Mobile Oil Corp.*, 453 U.S. 473, 483 (1981) (*quoting Schwegmann Bros. V. Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951)."

See also Sutherland Statutory Construction I §48.16 at p. 366.

[279] Hearings on H.R. 1301, H.R. 1543, and H.R. 2224 before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce, 102d Cong., 1st Sess. (May 1,2 and June 26, 1991), Statement of Cynthia A. Marlette, Associate General Counsel, Federal Energy Regulatory Commission, Report No. 102-60 at p. 60 and 61-70. *See also Id.* At p. 106 ("I believe that we have substantial authority under

face of such explicit testimony from the staff of the agency required to implement the statute, had Congress intended to limit the Commission's remedial authority under section 206 when it amended section 211, we believe it would have explicitly done so in the language of the statute itself, or at least have indicated its intent to do so in the Conference Report on the Energy Policy Act.[280]

C. Comparability

1. Eligibility to Receive Non-Discriminatory Open Access Transmission

In the NOPR, the Commission proposed to define who is eligible to receive service under a non-discriminatory open access tariff as follows:

> A non-discriminatory open-access tariff must be available to any entity that can request transmission services under section 211.[281]

The Commission further explained that "[u]nder section 211, any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale may request transmission services under section 211."[282]

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the existing case law to mandate access where necessary to remedy anticompetitive effects.").

[280] At the time Congress enacted amendments to FPA section 211, it was well aware that the Commission had unexplored authorities under sections 205 and 206 of the FPA to compel wheeling. The only explicit limitations it chose to impose on the Commission's wheeling authorities were those contained in sections 212(g) and (h), which provide that no order "under this Act" may be inconsistent with any State law governing retail marketing areas of electric utilities (section 212(g)), or be conditioned upon or require the transmission of electric energy directly to an ultimate consumer (section 212(h)).

[281] *FERC Statutes and Regulations* ¶32,514, at p. 33,083 (footnote omitted).

[282] *Id.* At p. 33,083 n.195.

Comments

PSNM believes that the NOPR properly defined customer eligibility. NIEP, on the other hand, believes that the proposed definition is too limited. It argues that the Commission should require public utilities to make transmission service available to all entities engaged in wholesale purchases or sales of power, not just to those "generating" power. Utility Working Group requests that the Commission

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clarify that eligibility is dependent not only on being the type of entity set forth in section 211, but on meeting the requirements of section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions) as well.[283]

We also received several comments related to the applicability of the rule to foreign entities. Canada states that the requirements for comparability and reciprocity should be implemented in a flexible manner to permit Canadian utilities to have fair and competitive access in the U.S. electricity market. Maritime requests that the Commission require Canadian utilities who wish to participate in the U.S. market to offer other utilities the same privileges they receive in the United States. Southwestern argues that transmission to a foreign country is in interstate commerce and that a utility should therefore accommodate this type of transmission request under its open access tariff. El Paso argues that the Commission does not have the authority to condition access to foreign countries, but states that if the Commission nevertheless exercises such authority it should do so on a case-by-case basis. Destec asserts that

the posturing of Ontario Hydro before U.S.

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[283] Section 212(h) (Prohibition on Mandatory Retail Wheeling and Sham Wholesale Transactions).

regulators pleading for open access and non-discriminatory transmission treatment—even for extra-territorial entities, should be met with a strong reply that such provisions should also be afforded transmission dependent entities on the Canadian side of the border. Ontario Hydro's aggressive pursuit of U.S. market opportunities while simultaneously blocking competitors through the control of their transmission assets can not be ignored.

Commission Conclusion

In the Final Rule pro forma tariff the Commission has modified the definition of "eligible customer" to address concerns that in some respects the NOPR definition was too limited and in other respects it was too broad. This includes amended language to clarify that any entity engaged in wholesale purchases or sales of energy, not just those "generating" electric power, is eligible. It also includes clarification that entities that would violate section 212(h) of the FPA (prohibition on Commission-mandated wheeling directly to an ultimate consumer and sham wholesale transactions) are not eligible. The language also has been modified to provide that foreign entities that otherwise meet the eligibility criteria may obtain transmission services. Further, it has been modified to provide for service to retail customers in circumstances that do not violate FPA section 212(h).[284]

Persons that would be eligible section 211 applicants also would be eligible under the open access tariffs. Section 211 applicants may be any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale.

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[284] We emphasize that *any* transmission customer must follow prudent utility practices so as to assure reliability.

Section 3(22) of the FPA, as amended by the Energy Policy Act, defines "electric utility" to mean

> any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

Thus, as we have previously noted, municipal utilities are electric utilities simply by the terms of the statute.[285] In addition, we have also found that cooperatives and marketers are electric utilities as defined in the FPA.[286] Other entities that fall within the definition include IOUs, IPPs, APPs, and QFs that sell electric energy.

We do not believe that entities that engage solely in brokering should be eligible. Such brokers do not take title to electricity and therefore do not engage in the sale of electric energy; nor do they generate electric energy for sale for resale.[287] [287]

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Although such brokers are not eligible under the tariffs, they will be able to arrange deals because they will have access to the OASIS of all public utilities and will be able to solicit

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[285] New Reporting Requirement Implementing Section 213(b) of the Federal Power Act and Supporting Expanded Regulatory Responsibility Under the Energy Policy Act of 1992, and conforming and Other Changes to Form No. FERC-714, Order No. 558-A, 65 FERC ¶61,324, at p. 62,451 n.12 (1993).

[286] Order No. 558, *FERC Statutes and Regulations* ¶30,980, at pp. 30,895-95, *reh'g denied*, 65 FERC ¶61,324 (1993) (cooperatives are electric utilities); *AES Power, Inc.*, 69 FERC ¶61,345, at p. 62,297 (1995) (power marketer is an electric utility, *i.e.*, a person "which sells electric energy").

[287] *See, e.g., Citizens Energy Corporation*, 35 FERC ¶61,198, at pp. 61,452-53 (1986).

information from the relevant transmission service providers under the terms of the applicable tariffs.

We clarify that foreign entities that otherwise meet the eligibility criteria must be eligible to receive service under the non-discriminatory open access transmission tariffs.[288] We are making this determination pursuant to our authority under section 206 of the FPA to remedy undue discrimination. As we explained in the NOPR, market power through the control of transmission can be used discriminatorily to block competition. Customers in the United States should not be denied access to cheaper supplies of electric energy, whether such electric energy is from a domestic source or a foreign source. By making non-discriminatory access available to foreign entities that otherwise meet the eligibility criteria, we are assuring that customers in the United States have access to as many potential suppliers as possible. This should result in increased competition and lead to customers paying the lowest possible prices for their electric energy needs. To the extent that such an entity obtains access, however, we emphasize that it would be subject to all of the terms and conditions of the applicable open access tariff, including the requirement that it provide reciprocal service.

Finally, we have reconsidered our NOPR position that would have limited eligibility to wholesale transmission customers. As we explained in the NOPR, the Commission's jurisdiction extends to *all* unbundled transmission in interstate commerce by public utilities. It is irrelevant to the Commission's jurisdiction whether the customer receiving the unbundled transmission service in interstate commerce is a wholesale or retail customer. Thus, if a public utility voluntarily offers unbundled retail access in interstate commerce or a state retail access program results in

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[288] In making this determination, we are not deciding whether these entities are eligible under section 211(a) of the FPA.

unbundled retail access in interstate commerce by a public utility, the affected retail customer *must* obtain its unbundled transmission service under a non-discriminatory transmission tariff on file with the Commission. Though the Commission may approve a separate retail transmission tariff when some variation is necessary or appropriate to meet local concerns,[289] we generally see no reason why retail transmission tariffs necessarily must be different from wholesale transmission tariffs. For that reason, we anticipate that in many circumstances the same open access tariff that serves wholesale customers will be equally appropriate for retail transmission customers. Therefore, unless the Commission has specifically permitted a separate retail tariff, eligible customers under the Final Rule pro forma tariff must include unbundled retail customers.[290] We discuss this further in Section IV.I.

While the rates, terms, and conditions of all unbundled transmission service will be subject to a Commission-authorized tariff, we will, in appropriate circumstances, give deference to state recommendations regarding rates, terms, and conditions for retail transmission service or regarding the proper transmission cost allocation to be used between retail and wholesale customers when state recommendations are consistent with our open access policies. This is also discussed further in Section IV.I.

Moreover, we are mindful of the fact that we are precluded under section 212(h) from ordering or conditioning an order on a requirement to provide wheeling directly to an

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289 *See* Section IV.I.

290 The Commission has no authority to order retail transmission directly to an ultimate consumer or to order "sham" wholesale transmission. *See* FPA section 212(h). However, if such access occurs voluntarily or as a result of a state program, the rates, terms, and conditions of the access are within our exclusive jurisdiction if the service is provided by a public utility.

ultimate consumer or sham wholesale wheeling. We therefore clarify that our decision to eliminate the wholesale customer eligibility requirement does not constitute a *requirement* that a utility provide retail transmission service. Rather, we make clear that if a utility chooses, or a state lawfully requires, unbundled retail transmission service,

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such service should occur under this tariff unless we specifically approve other terms.

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8. Consequences of Functional Unbundling

a. Distribution Function

The NOPR proposed functional unbundling of wholesale generation and wholesale transmission so that the public utility as a wholesale seller could not gain an undue advantage from its transmission ownership. We did not propose to further unbundle the retail transmission and distribution functions from the wholesale transmission function.

Comments

A number of commenters assert that utilities should be required to unbundle—either functionally or corporately—the distribution function from the transmission function. ELCON argues that unbundling distribution would help delineate state and Federal jurisdiction, facilitate the establishment of transmission pricing, avoid cross-subsidization, and prepare for the customer choice (retail wheeling) programs that will be implemented by states in the

future. It contends that functional distinctions between wholesale and retail service should be minimized.[331]

Other commenters, however, oppose establishing a separate distribution function. DOD asserts that the Commission can address any problems that arise by enforcing the terms of open access tariffs and that the Commission should not intrude into state ratemaking.[332]

Various state commissions question the workability and desirability of a functional test to determine the dividing line between retail transmission and local distribution.[333] CA Com recommends that, to avoid jurisdictional uncertainty surrounding functional unbundling, the Commission adopt a functional test for local distribution. Under this test, vertically integrated utilities that chose to unbundle

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into separate operating companies, including a local distribution company that sells only at retail, could establish a workable bright line between state and Federal authority without engaging in the arduous task of differentiating transmission from distribution.

Certain IOUs echo the jurisdictional concerns raised by the state commissions.[334] They believe that the unbundling of the distribution function would create significant jurisdictional problems. Pacificorp also argues that unbundling of the distribution function would create

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331 *See also* Environmental Action, Missouri Basin MPA, Texaco, EGA, AEC & SMEPA.

332 *See also* TDU Systems, Public Service Co. of CO.

333 E.g. NARUC, AZ Com, CT DPUC, OK Com, FL Com, NC Com, NM Com.

334 *E.g.*, Com Ed, Citizens Utilities, PacifiCorp.

significant jurisdictional conflict with respect to cost allocation.

Commission Conclusion

We conclude that the additional step of functionally unbundling the distribution function from the transmission function is not necessary at this time to ensure non-discriminatory open access transmission. Our approach to assuring such open access has two broad requirements: (1) functional unbundling of transmission and generation (which includes separately stated rates for generation, transmission, and ancillary services, and a requirement that a transmission provider take service under its own tariff), except for bundled retail service and (2) an OASIS with standards of conduct. We believe that additional requirements are not needed now. We further address in Section IV.I the concerns raised regarding our proposed tests to distinguish transmission and local distribution.

b. Retail Transmission Service

Comments

The majority of commenters addressing this issue believe that unbundling retail service is unnecessary to establish a competitive market and to achieve non-discriminatory open access transmission.[335] For example, PSNM argues that the Commission is not as well situated as are state regulators to oversee and supervise local reliability issues for retail customers. Central Illinois Public Service argues that due to the nature of transmission facilities and operations, it is not possible for the transmission provider to discriminate between the provision of wholesale and retail firm service. Several IOUs further contend that because the Commission is specifically precluded from mandating retail

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[335] *E.g.* Allegheny Power, PacifiCorp, MidAmerican, PECO, Public Service Co. of CO, Com Ed, NARUC, NRRI, MN DPS, ND Com, FL Com.

wheeling and has no authority over bundled retail service, the Commission cannot require retail service to be provided.[336]

In contrast, some commenters argue that functional unbundling must apply to all transmission service in interstate commerce provided by public utilities, including the transmission component of bundled retail sales.[337] They believe that this is necessary to achieve comparability. For example, CCEM asserts that if the distribution function is not unbundled, the result will be service under two separate arrangements—an explicit wholesale transmission tariff filed at the Commission and an implicit retail transmission tariff governed by a state regulatory body. According to CCEM, failure to unbundle retail transmission will allow transmitting utilities to manipulate how they characterize and account for their own uses of transmission. ABATE contends that the Commission, for efficiency reasons, should encourage states to permit retail access. It asserts that the Commission must adopt a policy that signals to states how rates, terms, and conditions of retail service will be established; once a state sets such parameters, the Commission should review them.

Commission Conclusion

Although the unbundling of retail transmission and generation, as well as wholesale transmission and generation, would be helpful in achieving comparability, we do not believe it is necessary. In addition, it raises numerous difficult jurisdictional issues that we believe are more appropriately considered when the Commission reviews unbundled retail transmission tariffs that may come before us in the context of a state retail wheeling program. The Commission therefore reaffirms its decision to require the unbundling

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336 [336] *E.g.*, Allegheny Power.

337 *E.g.*, CCEM, ABATE.

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only of wholesale transmission from generation.[338]

c. Transmission Provider

1. Taking Service Under the Tariff

In the NOPR, we explained that a public utility must take transmission services for all of its new wholesale sales and purchases of energy under the same tariff of general applicability under which others take service.[339]

Comments

A number of commenters argue that utilities should be required to take all of the transmission for their own use under their tariff.[340] CCEM asserts that a transmission owner should have to schedule, at arm's length, its retail transmission uses and pay posted rates into a separate account; otherwise the capacity might be overforecast at no cost.

PECO requests that the Commission clarify that the requirement that a transmission provider take service under its own transmission tariffs does not apply to: (1) Retail service, (2) existing wholesale contracts, and (3) pooling arrangements. UNITIL claims that the requirement for a transmission provider to take service under its own tariff and to post its own tariff rate should not apply to pool transactions where a single pool-wide rate is applied.

A number of IOUs contend that it is not necessary for the transmission provider to take service under the network tariff because both the transmission provider and the network

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338 *But see* discussion of buy/sell transactions in Section IV.I.

339 FERC Statutes and Regulations ¶32,514, at p. 33,080.

340 *E.g.*, Michigan Systems, Cleveland, Municipal Energy Agency Nebraska, Missouri Basin MPA, TAPS, Wisconsin Municipals, LG&E, NIEP, CCEM.

customers cannot use the tariff to make off-system sales. LILCO states that it is appropriate to distinguish between a transmission owner's use of its transmission system to make: (1) Wholesale bulk power sales; and (2) off-system purchases to serve its native load retail customers. LILCO contends that in the second situation it should not be required to take transmission service under its own open access tariffs.

EGA argues that transmission owners should be required to take transmission service under open access tariffs for both wholesale off-system sales and purchases. It maintains that, as retail competition increases, utilities will eventually have to take retail service under their own tariffs. Power Marketing Association believes that comparability can be achieved only if transmission service provided in connection with coordination transactions is unbundled and the transmission provider takes such transmission service under its tariff.

Consumers Power also claims that there is an inconsistency between the NOPR text, the tariffs, and the proposed regulatory language regarding whether the requirement for a utility to take service under its own tariff applies only to new wholesale transactions.

Commission Conclusion

We conclude that public utilities must take all transmission services for wholesale sales under new requirements contracts and new coordination contracts under the same tariff used by others (eligible customers).[341] For sales and purchases under existing bilateral economy energy coordination agreements, we will give an extension until

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[341] With the exception of certain contracts and agreements executed on or before 60 days after publication of the Final Rule in the *Federal Register*, the regulation we are adopting requires that public utilities take service under their open access tariff for wholesale sales or purchases of electric energy and unbundled retail sales of electric energy, effective on the date the public utility engages in such transactions.

December 31, 1996, for public utilities to take transmission service under the same tariff used by others.[342] As further discussed in Section IV.F., we will also give an extension of time to December 31, 1996, for certain existing power pooling and other multi-lateral coordination agreements to comply with this requirement. This will ensure that utilities live by their own rules for wholesale transactions and that we can achieve non-discriminatory open access transmission. In the case of a public utility buying or selling at wholesale, the

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public utility must take service under the same tariff under which other wholesale sellers and buyers take service.

2. Accounting Treatment

In the NOPR, we did not address any accounting aspects of our proposed rule.

Comments

IOUs generally object to a requirement that they pay themselves for their use of the transmission system.[343] NEPCO claims that it is a general principle of accounting that an enterprise cannot recognize and record revenues to itself. NEPCO suggests that, to ensure that utilities' financial statements are not misleading, this aspect of functional unbundling can and should be accomplished through the ratemaking process, rather than by requiring utilities to actually charge themselves revenues for taking transmission services.[344]

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342 As discussed in Section IV.F., the Commission will not impose this requirement on existing bilateral non-economy coordination agreements, but persons may file complaints that such agreements need to be modified.

343 *E.g.*, EEI, Con Ed, VEPCO.

344 *See also* NEPCO.

Atlantic City Electric states that the added costs of properly administering and accounting for these transactions separately will increase prices to ultimate consumers. It contends that ensuring that operators do not give undue preference to transactions of the transmission provider makes it unnecessary for a utility to charge itself.

CSW argues that some of the provisions of the tariffs were specifically designed for third parties and do not make sense as applied to the transmission provider (e.g., signing service agreements and running credit checks).[345]

Most IOUs suggest that a revenue credit mechanism be used to account for a transmission provider's use of its system. Florida Power Corp states that revenue credits should be equal to the utility's posted rates for transmission service multiplied by the amount of capacity reserved and/or energy transmitted by the utility.

Otter Tail proposes a revenue credit that allocates revenues based on use under the tariff of the utility's transmission investment and credits these revenues against the firm load customers' accounts.

Duke asserts that the transmission provider should maintain records reflecting transmission for its own transactions under the tariff and develop appropriate revenue credits for transmission rates. It also believes that all firm users of the transmission system should receive credits for all non-firm uses.

Allegheny Power states that the crediting of non-firm revenues to network customers would have to be done on an after-the-fact basis when their loads would be known. However, it believes that revenue crediting should occur only if the firm service customer has retained the utility to remarket the customer's unused capacity.

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345 *See also* Florida Power Corp.

Cajun proposes that all transmission revenues in excess of those implicitly included in the development of the transmission rates, including those that the utility has charged itself, be credited back to the network service transmission customers on a load ratio share basis. If transmission service rates are formula rates that are recalculated annually, Cajun proposes that excess transmission revenues be used to offset the recalculated revenue requirement. If the rates are not formula rates, Cajun states that an explicit tracker with monthly crediting to the network customer must be used.

To avoid cross-subsidization between affiliates and third parties, NRECA suggests that transmission revenues "paid" by a utility's generation function to its transmission function be credited back to the utility's nonaffiliated customers, and that any rate discounts extended to the generation function by the transmission function be filed with the Commission with a full explanation of why the discount was extended together with a showing that the discount was made available to all other similarly situated customers.

APPA contends that the Commission's current system of revenue crediting could give transmission owners an unfair competitive advantage by allowing them to use the revenue credit to subsidize the price at which they sell power. It argues that transmission owners should pay the actual price of transmission rather than booking a revenue credit as an offset to the cost of transmission service.

TAPS and Wisconsin Municipals argue that an essential element of true comparability

[31,702]

is the ongoing pass-through to network customers of a load ratio share of transmission revenues generated by third-party and the transmission provider's off-system uses of the transmission system.

Houston L&P suggests that the revenue crediting mechanism proposed in the NOPR could be established to recognize the utility's transmission service revenue and expenses in non-third-party wheeling transactions by reclassifying a portion of its revenue equal to the cost of transmission services provided to itself during such transactions. This mechanism would not reclassify expense accounts, but would distinguish that transmission portion of the total transaction's revenue that was associated with covering the cost of transmission service, using the rates charged in similar third-party transactions.

PacifiCorp contends that the Commission should enforce the requirement that utilities account for revenues they pay themselves through the commission's audit powers and through complaint proceedings. It specifically recommends that each transmitting utility be required to indicate, in its Form No. 1 under Account 456, the megawatts and revenues associated with its firm and non-firm off-system sales.[346]

MT Com states that the embedded costs that the Commission functionalizes for jurisdictional purposes should be carefully reconciled with plant balances used to calculate other costs of service.

CCEM wants each transmission provider to charge and book revenues into separate accounts for (1) service provided to itself and off-system sales and third-party sales under the tariffs, (2) impact study costs that the provider performs for itself or an affiliate, and (3) ancillary service revenues, net of out-of-pocket expenses the transmission owner provides itself or an affiliate.

Arizona Public Service recommends that any revenue crediting or booking be prospective only and that

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[346] If the utility is not required to file a Form No. 1, PacifiCorp states that it should be required to file similar information annually.

enforcement occur through the Commission's periodic audits and a utility's rate cases.

Many IOUs argue that there should be no obligation to credit non-firm transmission revenues to customers who are not using their firm capacity.[347] PacifiCorp contends that all non-firm revenues should be credited against total annual revenue requirements, resulting in lower rates to all customers. Wisconsin P&L maintains that non-firm sales revenue should be shared with all network customers.

Otter Tail argues that non-firm transactions between existing utilities to support and achieve real-time system optimization should be permitted without charge to the transmission owner. CSW asserts that no credits should be made for the non-firm secondary service under the point-to-point tariff and that off-system purchases for native load should not result in a revenue credit.

Southwestern suggests that the Commission not require the crediting of a transmission component associated with off-system purchases by the public utility. Southwestern argues that a credit would interfere with a utility's ability to buy the most economic energy for its native load customers. It also argues that requiring a credit is not comparable to what network customers pay. NEPCO points out that crediting transmission associated with purchases would require native load customers to pay the costs of the utility's purchasing off-system power while network customers do not have to pay a separate point-to-point charge for their off-system purchases. Southwestern claims that the crediting requirement would double-charge the transmitting utility and its native load customers because a utility's off-system purchases directly relate to the load it serves, and that load already is reflected in the transmission rate calculation.

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[347] *E.g.*, Consumers Power, Northern States Power, PacifiCorp, Allegheny Power.

Southwestern also claims that it is unclear from the NOPR whether the Commission considers sales from the renewal of existing wholesale requirements contracts as being subject to crediting. It argues that transmission related to these sales should not be subject to the crediting requirement because this is service to native load customers.

[31,703]

Brazos opposes imputing revenues associated with a utility's own use of its transmission system because this will artificially increase the cost of power and deny consumers the benefits of economy energy sales made at market-based prices.

Commission Conclusion

While we used the word "accounting" in the NOPR, the real issue is assuring that utilities bear the costs associated with their own uses of the system in a manner comparable to how they charge others. Accordingly, this is a rate issue, not an accounting issue. However, we direct utilities to account for all uses of the transmission system and to demonstrate that all customers (including the transmission provider's native load) bear the cost responsibility associated with their respective uses.[348]

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b. Services That May Be Offered and Sold as a Package

The NOPR indicated that ancillary services must be offered separately from one another but did not indicate if the transmission provider may also offer a package of ancillary services.

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348 Additional guidance on this subject is in Section IV.G.4.g.(2)(a).

Comments

Several commenters support giving customers the option either to purchase ancillary services as separate and distinct services or to purchase a package of services from the transmission provider.[394] Others, such as Tallahassee, recommend that utilities be prohibited from bundling the purchase of one service with another so that a transmission customer cannot

[31,719]

rely on the transmission provider for just one or a few of the ancillary services.

EEI and ELCON argue that the Commission should permit customers the option to request that transmission providers offer packages of selected ancillary services.[395] They and other commenters express a concern that efficiencies can be lost under a policy that precludes combining ancillary services.

Commission Conclusion

We conclude that a transmission provider must offer and price the individual ancillary services separately. It may not tie the purchase of one to the purchase of another.

However, we will allow a transmission provider to assemble packages of ancillary services (not bundled with basic transmission service) that can be offered at rates that are less than the total of individual charges for the services if purchased separately. It may also offer rate discounts on any ancillary service. If a rate discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discount must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be

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394 *E.g.*, Direct Service Industries, Mt. Hope Hydro, ELCON, Pa. Com.

395 EEI Initial Comments at V-4, ELCON Initial Comments at p. 21.

on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

4. Reassignment of Ancillary Services

In the NOPR, the Commission noted that ancillary services may not be suitable for reassignment and requested comments on this issue.

Comments

Commenters express divided views on the reassignment issue. Some IOU commenters believe that, subject to technical limitations, ancillary services could be reassigned.[396] Other commenters, including many IOUs, oppose reassignment because they believe it is impractical.[397] In particular, PacifiCorp claims that the customer-specific nature of generation-related ancillary services prevents such services from being reassigned.

TDU Systems argue that transmission customers that must pay for ancillary services they do not need should be able to resell them to someone else.[398] Mt. Hope Hydro claims that, if a bulk power transaction and the associated transmission service can be reassigned, it is reasonable that the ancillary services used to support the transaction also should be reassigned, particularly if the same facilities and contract path are used.[399]

Commission Conclusion

We conclude that transmission customers will be allowed to reassign ancillary services along with the reassignment of basic transmission service. The Commission believes that a policy of transmission capacity reassignment

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396 *E.g.*, WP&L, NYSEG.

397 *E.g.*, Consumers, PacifiCorp, Carolina P&L, PSNM, Salt River, PA Com, TDU Systems.

398 TDU Systems Initial Comments at p. 87.

399 Mt. Hope Hydro Initial Comments at p. 17.

may not be possible unless the ancillary services used to support the transmission are also reassignable.

5. Pricing of Ancillary Services

In the NOPR, we asked for comments on ancillary service pricing and proposed specific ancillary services prices in the Stage One implementation rates. Many commenters commented on the Stage One rates. There is no Stage One in the Final Rule.

Comments

Many commenters state that ancillary services are difficult to price. They suggest diverse pricing approaches. IN Com notes that, because utilities and regulatory commissions have no experience with pricing unbundled ancillary services, the process needs to evolve but the goal should be to encourage market pricing in competitive markets. Air Liquide believes the best pricing policy should be negotiated bilateral agreements, provided market power is mitigated.

Other commenters express concern about how pricing proposed in the NOPR would affect the development and operation of competitive ancillary services markets. Industrial Energy Applications

[31,720]

notes that low price caps on generation-related services, such as supplying losses, imbalance energy, operating reserve and backup power, which can be provided from many sources, inhibit competitive market development. There is little incentive for other providers to invest in facilities to provide these services. Dayton P&L and others contend that the Commission should not require transmission providers to provide generation-based ancillary services at cost-based rates and then allow third parties to resell such services at market-based rates. PacifiCorp expresses concern that the NOPR's pricing proposal would be overly restrictive in the

emerging competitive market for generation-related ancillary services.

Many commenters argue that cost-based price caps are appropriate for ancillary services if there are no alternative suppliers or until competitive markets develop.[400] AMU suggests that the comparability standard is not met if market rates exceed the costs of providing ancillary services. Allegheny, Ohio Edison and Atlantic City support cost-based pricing for Reactive Power/Voltage Control. Ohio Edison recommends cost-based pricing for frequency regulation, and Atlantic City recommends it for scheduling and dispatch.

Several commenters suggest that the Commission require cost-based rates for ancillary services where no source other than the transmission provider exists and market-based rates for generation-related ancillary services if competition exists.[401] Washington and Oregon Energy Offices recommend that, before permitting market-based rates, at least two other non-affiliated parties should be able to offer a nearly identical ancillary service and that the Commission should use the same standards for allowing market-based rates for ancillary services that it has used for wholesale power sales. Mt. Hope Hydro argues that vertically integrated utilities should be permitted to charge cost-based rates that are limited to no more than the market price for ancillary services. It also contends that companies whose generation facilities are not supported by captive retail or transmission customers should be authorized to sell at market-based prices.

The vast majority of commenters from all interest groups who address market-based pricing for ancillary services agree that market-based pricing is appropriate for ancillary

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400 *E.g.*, Utilities For Improved Transition, Idaho, CINergy, Direct Service Industries, Mt. Hope Hydro, ABATE, TDU Systems, Missouri-Kansas Industrials, Washington and Oregon Energy Offices, IN Com.

401 E.g., PJM, Texas Utilities, Entergy, Carolina P&L.

services where competitive market conditions exist. However, commenters disagree over whether a competitive market for ancillary services currently exists.

In determining the extent of competition, many commenters distinguish between ancillary services that are (1) generation-related and (2) transmission-related. Commenters disagree over whether the Commission can declare generation-related ancillary services to be competitive on a generic basis. Many commenters contend that transmission-related ancillary services are not available in a competitive market; consequently, they agree that prices for such services should be cost-based.

Commission Conclusion

We will consider ancillary services rate proposals on a case-by-case basis.

In response to comments,[402] we offer here some general guidance on ancillary services pricing principles.

(1) Ancillary service rates should be unbundled from the transmission provider's rates for basic transmission service, even though such services are a necessary adjunct to basic transmission service.

(2) The fact that we have authorized a utility to sell wholesale power at market-based rates does not mean we have authorized the utility to sell ancillary services at market-based rates.

(3) In the absence of a demonstration that the seller does not have market power in such services, rates for ancillary services should be cost-based and established as price caps, from which transmission providers may offer a discount to

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[402] Many commenters were particularly concerned that rates for energy losses, a NOPR ancillary service, should be market-based. We need not address this concern in this Rule, however, because we will not require Real Power Losses to be offered as an ancillary service.

reflect cost variations or to match rates available from any third party. If a rate

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discount is offered to the transmission owner itself or to an affiliate of the transmission owner, the same discounted rate must be offered to non-affiliates, as well. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory. All discounts must be posted on the transmission provider's OASIS.

(4) The amount of each ancillary service that the customer must purchase, self-supply, or otherwise procure must be readily determined from the transmission provider's tariff and comparable to the obligations to which the transmission provider itself is subject. The provider must take ancillary services for its own wholesale transmission under its own tariff.

(5) The location and characteristics of a customer's loads and generation resources may affect significantly the level of ancillary service costs incurred by the transmission provider. Ancillary service rates and billing units should reflect these customer characteristics to the extent practicable.

6. Accounting for Ancillary Services

Comments

Some commenters suggest that there may be a need for revising the Uniform System of Accounts to track better the costs of providing discrete ancillary services. Other commenters believe that ancillary services are transmission-type services and suggested that the costs of generation-provided ancillary services be refunctionalized from power production expense to transmission expense.

Oak Ridge asserts that a primary goal of those interested in restructuring the electricity industry should be to identify clearly the different functions that are today buried within the vertically integrated utility and bundled into one price. Oak

Ridge, however, indicates that achieving this ideal of identifying unbundled services at appropriate prices will be difficult because of utility accounting practices.

EEI asserts that since the current Uniform System of Accounts was designed to track costs incurred to provide bundled wholesale service, it does not track the discrete costs incurred to provide ancillary services. Therefore, according to EEI, a major update is needed to support the pricing of discrete ancillary services.

ConEd states that ancillary services are integral and essential elements of providing transmission services. It notes that, historically, due to the vertical integration of utilities, those services have been bundled with the other services provided and the costs associated with providing ancillary services have not been specifically defined. ConEd claims that to a large degree, this is due to the fact that utility accounting mechanisms were not established with the intention of identifying the costs for ancillary services.

UI asserts that if transmission customers are to be charged for certain ancillary services, it may be necessary to refunctionalize certain specific costs items from generation to transmission. UI points out that some of the reactive power to support system voltages and to provide transmission services, for example, is supplied from the variable reactive output of the generators. It states that these costs, to the extent they can be identified with the provision of transmission service, should be refunctionalized to the transmission account. However, UI states it may not be possible to develop a unit cost for specific transactions. Thus, UI states it may be more appropriate to roll these costs into the embedded transmission rate and allocate them among the various users of the transmission system.

Commission Conclusion

To ensure comparable transmission access a Transmission Provider is obligated to offer or arrange to

provide certain ancillary services to the Transmission Customer. Also, the Transmission Provider may offer to provide other ancillary services to the Transmission Customer. A Transmission Customer is obligated to purchase certain ancillary services from the Transmission Provider.

Generation resources provide certain ancillary services, while transmission resources provide other ancillary services. Consequently, the costs of providing certain ancillary services are recorded in the utility's power production expense accounts, while others are recorded in the utility's transmission expense accounts.

Currently, the Uniform System of Accounts requires that costs incurred in providing ancillary services be recorded as power production or transmission expense depending upon which resource the utility uses to supply the service. At this time,

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we are not convinced that the amounts involved or the difficulty associated with measuring the cost of ancillary services warrants a departure from our present accounting requirements. We will specify, however, that revenues a Transmission Provider receives from providing ancillary services must be recorded by type of service in Account 447, Sales for Resale, or Account 456, Other Electric Revenues, as appropriate.

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4. Bilateral Coordination Arrangements

Any bilateral wholesale coordination agreement executed after the effective date of this Rule will be subject to the functional unbundling and open access requirements set forth in this Rule. With regard to existing bilateral

agreements, however, the diversity of the types of agreements currently on file presents special implementation problems. The Commission is particularly concerned with future economy energy transactions that may occur pursuant to existing umbrella-type

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coordination agreements. Accordingly, we shall require all bilateral economy energy coordination contracts executed before the effective date of this Rule to be modified to require unbundling of any economy energy transaction occurring after December 31, 1996. All non-economy energy bilateral coordination contracts executed before the effective date of this Rule will be permitted to continue in effect, but will be subject to complaints filed under section 206 of the FPA. Under those procedures, the rates, terms, and conditions of individual coordination contracts may be challenged as unduly discriminatory or otherwise unlawful.

To compute the unbundled coordination compliance rate, the utility must subtract the corresponding transmission unit charge in its open access tariff from the existing coordination rate ceiling. For example, if a utility has a coordination rate ceiling for hourly service of incremental cost plus 15 mills/kWh and a transmission tariff rate for hourly service of 3 mills/kWh, it shall revise the coordination rate ceiling to incremental cost plus 12 mills/kWh. The Commission cautions that the compliance filing will be strictly limited to removing the current transmission tariff price from the coordination price and will not be a medium for otherwise revising the residual coordination sales price.

The transmission rate for the coordination transactions may be at or below the tariff rate. However, if a utility's transmission operator offers a discounted transmission rate to the utility's wholesale marketing department or an affiliate for the purposes of coordination transactions, the same discounted rate must be offered to others for trades with any

party to the coordination agreement. In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory.[424] This may require parties to file modifications of the coordination arrangements.

ISO Principles

The Commission recognizes that some utilities are exploring the concept of an Independent System Operator and that the tight power pools are considering restructuring proposals that involve an ISO. While the Commission is not requiring any utility to form an ISO at this time, we wish to encourage the formation of properly-structured ISOs. To this end, we believe it is important to give the industry some guidance on ISOs at this time. Accordingly, we here set out certain principles that will be used in assessing ISO proposals that may be submitted to the Commission in the future.

These principles are applicable only to ISOs that would be control area operators, including any ISO established in the restructuring of power pools. We recognize that some utilities are exploring concepts that do not involve full operational control of the grid. Without in any way prejudging the merits of such arrangements, the following principles do not apply to independent administrators or coordinators that lack operational control. We do not have enough information at this time to offer guidance about such entities, but recognize that they could perform a useful role in a restructured industry.

Because an ISO will be a public utility subject to our jurisdiction,[425] the ISO's operating standards and procedures must be approved by the Commission. In addition, a properly

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[424] All discounts must be posted on the transmission provider's OASIS.

[425] A public utility is any person that owns or operates facilities used for the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale in interstate commerce. An ISO will operate facilities used for the transmission of electric energy in interstate commerce and thus will be subject to the Open Access and OASIS rules.

constituted ISO is a means by which public utilities can comply with the Commission's non-discriminatory transmission tariff requirements. The principles for ISOs are:

1. The ISO's governance should be structured in a fair and non-discriminatory manner. The primary purpose of an ISO is to ensure fair and non-discriminatory access to transmission services and ancillary services for all users of the system. As such, an ISO should be independent of any individual market participant or any one class of participants (e.g., transmission owners or end-users). A governance structure that includes fair representation

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of all types of users of the system would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner. The ISO's rules of governance, however, should prevent control, and appearance of control, of decision-making by any class of participants.

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G. Pro Forma Tariff

In the NOPR, the Commission stated that—

> all utilities use their own systems in two basic ways: to provide themselves point-to-point transmission service that supports coordination sales, and to provide themselves network transmission service that supports the economic dispatch of their own generation units and purchased power resources (integrating their resources to meet their internal loads).[426]

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426 *FERC Statutes and Regulations* ¶32,514, at p. 33,079.

Accordingly, the Commission proposed two pro forma tariffs in Appendices B and C of the NOPR: One for point-to-point service and one for network service. Our goal was to encourage the development of competitive bulk power markets by ensuring that all participants would be able to secure transmission services on a non-discriminatory basis. We attempted in the NOPR pro forma tariffs to articulate the minimally acceptable terms and conditions of service for point-to-point and network transmission service that were required to ensure non-discriminatory transmission service.[427] We explained that, for the most part, specific pricing provisions were omitted. We asked for

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comments on whether these tariffs provided a good basis for defining the minimum acceptable non-price terms and conditions of service.[428]

Subsequently, in a June 28, 1995 order, we encouraged public utilities to file open access transmission tariffs as soon as possible.[429] Tariffs with terms and conditions of service substantively similar to the NOPR pro forma tariffs would become effective without a refund condition, assuming there were no other concerns, *e.g.*, rate issues. We also indicated that these tariffs would be subject to revision based on the Final Rule.

Unified Pro Forma Tariff

The Commission received many comments on both the point-to-point and network tariffs. Many commenters suggested improvements to the proposed tariffs. Others took

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427 *Id.* at p. 33,092.

428 On October 27, 1995, the Commission's staff sponsored a technical conference on the pro forma tariffs.

429 American Electric Power Service Corporation, et al., 71 FERC ¶61,393, modified, 72 FERC ¶61,287 (1995).

issue with how to reconcile various aspects of service under the two tariffs (e.g., cost allocation, service priority, customer rights and obligations). As discussed below, the Commission has attempted to address these concerns in developing tariff requirements for the Final Rule. Importantly, while the Commission has retained point-to-point transmission service and network transmission service as distinct services, the requirements for the two services are now in a single pro forma tariff.[430] The Final Rule pro forma tariff eliminates many of the differences between the two NOPR pro forma tariffs, provides a unified set of definitions, and consolidates certain common requirements such as the obligation to provide ancillary services. The general terms and conditions of transmission service specified in the Final Rule pro forma tariff should be familiar to all utilities, particularly those that have voluntarily filed open access tariffs based on the NOPR pro forma tariffs.

The Commission believes that the modified, single pro forma tariff, in conjunction with the other requirements, is sufficient to remedy undue discrimination in the provision of transmission services. However, we note that in an accompanying notice of proposed rulemaking in Docket No. RM96-11-000, we are seeking comments on whether a different form of open access tariff—one based solely on a capacity reservation system—might better accommodate competitive changes occurring in the industry while ensuring that all wholesale transmission service is provided in a fair and non-discriminatory manner.

We address below the comments received on the NOPR tariff and the specific modifications we have made in the Final Rule pro forma tariff.

1. Tariff Provisions That Affect The Pricing Mechanism

a. Non-Price Terms and Conditions

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[430] The Final Rule pro forma tariff is attached as Appendix D.

Comments

Utilities For Improved Transition argues that any generic imposition of detailed tariffs on the electric industry will stifle the evolution of the industry. Rather, it asserts, utilities that supply transmission service should be permitted to apply general principles of comparability in their company-specific tariffs, using terms and conditions of service based on their own particular circumstances and those of their customers.

Utility Working Group wants the final rule to allow utilities to depart from the pricing method implicitly contained in the NOPR pro forma tariffs. It argues that the final rule should recognize that some terms and conditions may not make sense in the context of innovative pricing proposals.

DOE thinks that it is proper to base the tariffs on a familiar and simple pricing method. However, DOE suggests that, in the future, the Commission carefully assess the workability of the contract path model in a competitive bulk power market. DOE suggests that spot or real-time pricing should be considered.

Numerous commenters contend that the NOPR pro forma tariffs are based upon the contract path, embedded cost methodology. According to EEI and other IOU commenters, conforming changes may be needed to various terms and conditions

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of the tariffs to implement pricing methodologies that are not based upon contract path. These commenters argue that any flow-based model would necessitate different non-price terms and conditions. The commenters generally recognize the technical difficulties of implementing a flow-based

model.[431] These commenters assert that the NOPR pro forma tariffs, as written, are not independent of pricing.

EGA criticizes the assumption underlying the contract path approach, i.e., that the capacities of individual transmission paths can be determined independently and made available to third parties. EGA notes that, in light of the competitive implications associated with transmission pricing, some utilities may propose other non-price terms and conditions suitable for other pricing methods, including power-flow-based tariffs. EGA expresses concern that the pro forma tariffs will be the only type of tariff allowed. EGA believes that the Commission should follow its transmission pricing policy guidelines and not impose a special burden on parties proposing tariffs that differ from the final rule pro forma tariffs, including non-price terms that support alternative pricing methods.

Some commenters also interpret the lack of reference to opportunity cost and incremental cost in the NOPR pro forma tariffs as a rejection of their use.[432]

Commission Conclusion

We agree that non-price terms and conditions cannot be designed independent of pricing and cost recovery. As discussed in detail below, the Final Rule pro forma tariff is intended to *initiate* open access, with non-price terms and conditions based on the contract path model of power flows and embedded cost ratemaking. It is designed based on the practices and procedures currently used by virtually all public utilities and complements the large number of tariffs already filed with the Commission. The Final Rule pro forma tariff is not intended to signal a preference for contract path/embedded cost pricing for the future. We recognize that

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[431] Additional comments concerning transition to flow-based pricing are summarized in Section IV.A.6.

[432] *E.g.*, BPA, Utilities For Improved Transition, PG&E, Duke.

the industry, in response to changes in institutions, competitive pressure, and technological innovations, is evolving rapidly. For example, various forms of flow-based pricing are beginning to be considered in conjunction with electronic transmission information systems. We seek to encourage this process and will in the future entertain non-discriminatory tariff innovations to accommodate new pricing proposals.[433]

In response to various comments, we are revising certain non-price terms and conditions where suggested changes either improve the tariff services or reconcile tariff inconsistencies. The nature of these tariff revisions does not appear to have serious cost consequences. The mandated changes are generally compatible with the rate proposals already filed by many public utilities. As discussed in Section IV.H., those utilities will not be required to file corresponding rate changes due to our mandated tariff changes to non-price terms and conditions, although they will be permitted to do so.

The Final Rule pro forma tariff includes specific terms and conditions rather than general principles. By initially requiring a standardized tariff,[434] we intend to foster broad access across multiple systems under standardized terms and conditions. However, in response to concerns raised by certain commenters, the tariff provides for certain deviations where it can be demonstrated that unique practices in a geographic region require modifications to the Final Rule pro forma tariff provisions. Accordingly, where applicable, the tariff permits the use of alternative non-price terms or

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[433] We further clarify that, contrary to some commenters' interpretation, the Final Rule pro forma tariff is in no way a rejection of opportunity or incremental cost pricing.

[434] As noted in Section IV.H., public utilities may propose variations that are consistent with or superior to the terms and conditions in the Final Rule pro forma tariff.

conditions that are reasonable, generally accepted in the region, and consistently adhered to by the transmission provider.

Finally, we will allow utilities to propose a single cost allocation method for network and point-to-point transmission services. These principles, as well as other

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modifications and clarifications to the NOPR pro forma tariffs, are discussed in detail below.

b. Load Ratio Sharing Allocation Mechanism for Network Service

Comments

Some commenters believe that load ratio cost allocation is appropriate for network service.[435] Other commenters argue that load ratio cost allocation is inappropriate, but disagree on the alternative. They offer a variety of other cost allocation and pricing methods.

The most frequent comment is that network and point-to-point services should be priced on the same basis. Florida Power Corp wants network contract demand to be offered and priced on a 12 CP basis.[436] ConEd and Duke argue that their systems are built and designed to meet a single peak; therefore, they contend that network service costs should be allocated with a load ratio calculation based on annual system peak rather than 12 CP. PSE&G claims that load ratio cost allocation works only if the customer has its own generation. Many commenters propose that "behind the

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435 *E.g.*, PSNM, WP&L.

436 Florida Power Corp's contract demand proposal would allow a network customer to nominate less than its full load for transmission service.

meter" generation and load be eliminated from the network load ratio calculation.[437]

CINergy notes that the transmission provider's monthly load ratio calculation includes its long-term off-system firm service. It proposes that off-system sales be eliminated from the load ratio calculation to enable the transmission provider to offer discounts on long-term service. Alternatively, CINergy proposes that the revenues from these long-term off-system sales be shared with network customers based on their load ratio.

Atlantic City and Allegheny contend that cost allocation for network service should also reflect customers' relative energy use (*i.e.*, not just customers' coincident demand). Consequently, these commenters propose that cost allocation consider the network customer's actual load factor. Allegheny also proposes adding a minimum revenue provision to the load ratio method to recognize cost responsibility for non-peak use. Allegheny further proposes to include an increasing return on equity as available transmission capacity decreases. EEI proposes that cost allocation be based on a customer's non-coincident peak demand.

Lower Colorado River Authority proposes using load flow studies to determine planned use during the system peak with MW-mile billing units. It believes that this pricing method should be used for all transmission service to ensure comparable transmission pricing. Oklahoma G&E wants cost allocation to be based on the impacted MW-mile method, or alternatively, to determine embedded cost by voltage level. Centerior proposes the use of actual transfer capability instead of contract path capability in determining cost responsibility.

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[437] *E.g.*, Cajun, NRECA.

Orange & Rockland recommends some form of a "poolco" approach using locational marginal cost pricing. DOE also recommends using location-specific spot pricing (a form of marginal cost) for operating and congestion costs.

Public Generating Pool believes that load ratio share pricing is unworkable in the Pacific Northwest, in part because generation is generally located outside of the control area directly served by parties in the Northwest, and in part because BPA, which does not have a typical service territory, dominates the regional transmission market. Seattle states that cost allocation based solely on demand is inappropriate for systems that consist predominantly of hydro generation.[438]

AEC & SMEPA and NRECA are concerned about pancaked rates for network service that is provided to load served by more than one network tariff. Other commenters advocate use of some form of regional pricing.[439] American Wind proposes the use of a complex seasonal calculation, which appears to benefit wind energy. NY Com and Missouri-Kansas Industrials also express a preference for seasonal pricing models.

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g. Ceiling Rate for Non-Firm Point-to-Point Service

Comments

Commenters generally support a ceiling rate for non-firm transmission service, capped at the firm rate.[453] Others

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[438] Additional comments concerning the Pacific Northwest are summarized in Section IV.K.

[439] *E.g.*, OH Coops, Municipal Energy Agency Nebraska, UT Com.

[453] *E.g.*, Duke, SCE&G, AEP, FPL.

request clarification as to whether the point-to-point tariff rates are fixed or are ceiling rates. Central Illinois Public Service's major concern is that, if the rates are fixed, the tariffs may result in higher prices for capacity and energy than those currently allowed for bundled service.

NYSEG argues that unequal pricing is a natural phenomenon of the open marketplace and requests assurance that offering transmission service at prices below a cost-based ceiling rate will not expose a transmission provider to claims of undue discrimination.

AEC & SMEPA opposes using the firm rate as the cap for non-firm transmission service. It states that, given the substantially lower quality of non-firm service (with no obligation to plan for such service), no cost-of-service principle justifies charging rates for non-firm service as high as the rate for firm service.

EGA and NRECA state that any discounts from the maximum firm rate must be uniform, transparent, readily understood, and posted on a RIN. According to CCEM and NRECA, the transmitting utility must have nondiscriminatory discount practices and must contemporaneously offer discounts to transmission customers at the same time and on the same basis as discounts for internal sales operations or affiliates.

Commission Conclusion

We believe that it is important to continue to allow pricing flexibility. In accordance with the Commission's current policies, the rate for non-firm point-to-point transmission service may reflect opportunity costs. Any provisions for opportunity cost pricing for non-firm service must meet the requirements already discussed. If a utility chooses to adopt opportunity cost pricing, the non-firm rate is effectively capped by the availability of firm service and is not subject to a separately-stated price cap. If a utility chooses not to adopt opportunity cost pricing, the non-firm

rate is capped at the firm rate. We also wish to ensure that non-firm transmission service is priced in a nondiscriminatory fashion. Accordingly, if a transmission provider offers a rate discount to its affiliate, or if the transmission provider attributes a discounted rate to its own transactions, the same discounted rate must also be offered at the same time to non-affiliates on the same

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transmission path and on all unconstrained transmission paths. We will further require that any affiliate discounts from the maximum firm rate must be transparent, readily understandable, and posted on the transmission provider's OASIS in advance so that all eligible customers have an equal opportunity to purchase non-firm transmission at the discounted rate.[454] In addition, discounts offered to non-affiliates must be on a basis that is not unduly discriminatory and must be reported on the OASIS within 24 hours of when available transmission capability (ATC) is adjusted in response to the transaction. As discussed in the RIN section, information, including the price for all non-firm transaction discounts, must be posted on the OASIS to ensure comparability.

2. Priority For Obtaining Service

Comments

The term "priority" is used in the comments in several senses. The intent of the comment depends on which kind of "priority" is intended. In general, there are comments about

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[454] The same requirements will apply to discounts from firm transmission service. Similarly, if a transmission provider offers an affiliate a discount for ancillary services, or attributes a discounted ancillary service rate to its own transactions, it must offer at the same time the same discounted rate to all eligible customers. Discounted ancillary services rates must be posted on the OASIS pursuant to new Part 37 of the Commission's regulations.

the order in which parties can obtain new service, which we call "reservation priority," and there are comments about the order in which parties lose service they already have, which we call "curtailment priority." Commenters may establish different reservation priorities for various services, such as network, off-system sales, firm, ability to reserve a portion of new transmission capacity to be constructed, and so on. Curtailment priorities also differ with the type of service. However, many commenters assert that certain parties should or should not have "priority" without distinguishing the kind of priority or type of service for which priority is intended.

a. Reservation Priority for Existing Firm Service Customers

Comments

Many IOUs, state commissions, and cooperatives strongly believe that native load should have priority to reserve transmission capacity under the tariffs.

EEI suggests that existing and future allocations of transmission capacity must be based on proper transmission pricing or, in its absence, priority of service. According to EEI, retail and existing wholesale requirements service should have the highest priority for use of transmission capacity, followed by long-term point-to-point service. Dayton P&L supports a continued preference for native load growth because native load customers have borne the majority of the costs of the transmission system. Detroit Edison, EEI, and Florida Power Corp claim that, because native load and network customers pay higher rates during all hours, such customers should have higher priority for service requests than others requesting transmission service. These commenters also claim that the transmission provider should be able to reserve firm capacity for native load and network service customers.

Similarly, NARUC wants wholesale and retail native load customers to be held harmless from functional

unbundling of wholesale transmission services. Because these customers have borne the vast majority of the costs of the utility's transmission facilities, NARUC argues that priority of service, quality of service, and allocation of joint and common costs to native load customers should not be affected by the transition to an open access transmission regime.

PA Com does not share the Commission's concern that a transmission provider may discriminate against a third party transmission customer vis-a-vis native load. It finds nothing impermissible in this sort of discrimination, arguing that the interconnected system was financed by, designed for, and built to serve native load.

NRECA explains that most transmission customers that seek network service will already be receiving similar service (albeit in a bundled form) from their transmission providers. It argues that these customers should receive the same priority of service as the transmission provider's native load customers for as long as they continue to take network service, whether under a current bundled whole

[31,745]

sale supply contract, a private transmission contract, or a network tariff.[454]

East Kentucky requests that the final rule clarify that member distribution cooperatives of G&Ts will have priority over third parties in the use of the G&T's existing transmission facilities. TVA comments that native load customers and emergency service to neighboring systems should have a higher service priority than transmission services sold to third parties (where an alternative power supply is available to the third party).

Commission Conclusion

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[454] *See also* American Forest & Paper, AMP-Ohio.

We reiterate that we are not requiring the transmission provider to unbundle transmission service to its retail native load nor are we requiring that bundled retail service be taken under the terms of the Final Rule pro forma tariff. However, the amount of transmission capacity available to wholesale and unbundled retail customers under the Final Rule pro forma tariff is clearly affected by the amount of transmission capacity that the transmission provider reserves for the use of its native load customers and the future load growth of those customers. The transmission provider may reserve in its calculation of ATC transmission capacity necessary to accommodate native load growth reasonably forecasted in its planning horizon. However, the transmission provider is obligated to provide transmission service to others under the Final Rule pro forma tariff out of capacity reserved for native load growth up to the time the capacity is actually needed for such future needs. Furthermore, as we explained previously, while existing wholesale customers do not have any ownership-like rights to the capacity they used during the term of their contract, they will have a right of first refusal to that capacity after the expiration of their contracts or when their contracts become subject to renewal or rollover.[455]

b. Reservation Priority for Firm Point-to-Point and Network Service

Comments

A number of commenters argue that all firm service should not be treated equally. These commenters argue that the price of the service should determine the priority that the service receives. A large number of IOUs and potential network customers (existing requirements customers) argue that in light of the pricing implicit in the NOPR, (*i.e.*, 12 CP for network versus annual system peak for point-to-point) network service should have priority over point-to-point

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[455] *See* discussion in Section IV.A.5.

service (because, all other things being equal, the price for network service will be higher).

BG&E believes that a customer receiving service priority equal to native load and network customers should pay comparable rates. Thus, BG&E argues that either flexible firm point-to point service should be priced the same as network service, or point-to-point service should have a lesser priority than native load and network service customers if point-to-point service is priced lower than network service.

DE Muni believes that native load and network customers must have priority access to interfaces (particularly where they are constrained) after system reliability concerns have been satisfied. The same argument is advanced by commenters concerning long-term service versus short-term service. Public Generating Pool argues that long-term service should always have priority over short-term service because long-term customers contribute more towards fixed-cost recovery than do short-term customers.

Cajun objects to having its service and service to its customers, which it characterizes as network service, receive the same priority as firm point-to-point service customers who take service for periods as short as one hour. Cajun points out that it, as well as other network and native load customers, have been paying and will be paying for the transmission facilities in place to serve their needs for many years. According to Cajun, the transient firm point-to-point customer should not have equal standing. Cajun suggests, however, that a long-term firm point-to-point customer taking service for ten years or more should have service priority equal to native load and network service customers.

SC Public Service Authority argues that the availability of short-term firm service with a priority equal to long-term service would provide a means for short-term

customers to obtain the advantages of long-term firm service at a much lower total cost. As a result, it argues that a few point-to-point customers would opt for long-term firm service, and the burden of the residual costs of the transmission system would fall on network customers.

EEI claims that priority for point-to-point service should be on a continuum of firmness, with reservation (as well as curtailment) priority based upon duration of service and specific negotiated terms. EEI proposes that the point-to-point tariff be modified to provide a first-tier category of flexible point-to-point transmission service that is comparable in priority, price, length, and terms of service to network service. EEI believes that this modification will resolve the problems that are associated with establishing priorities between network service and point-to-point service if the Commission retains different CP cost allocation methods for each service.

On the other hand, CCEM, a group of power marketers, supports the concept that all firm service should be treated equally, regardless of the term or the nature of service.

Commission Conclusion

An essential element of non-discriminatory transmission access is the right of transmission customers to reserve and purchase transmission service that is of the same quality as that used by the transmission provider in serving its wholesale requirements customers and retail load. Thus, we reject the proposal of some commenters that transmission providers need not provide firm point-to-point service that is of the same "firmness" as the transmission provider's service to native load. However, the fact that both network service and point-to-point service are provided on an equally firm basis does not mean that both types of service must be priced or reserved in the same manner.

The comments about reservation priorities for firm services boil down to two concerns. First, due to the

differences in pricing firm point-to-point service and network service implicit in the NOPR (*i.e.*, twelve-monthly CP pricing for network versus annual system peak for point-to-point), some commenters believe that network service should have priority over point-to-point service. Second, some commenters maintain that according firm, short-term point-to-point service a priority equal to long-term service provides a means for short-term customers to avoid making a fair contribution to the long-term costs of the system.

With respect to the first concern, we have eliminated the differences in pricing by permitting utilities to adopt point-to-point reservations as the customer load. As discussed above, for purposes of the Final Rule pro forma tariff, utilities are free to propose a single cost allocation method for the two services.

The second area of concern arises because of the first-come first-served reservation priority in the NOPR point-to-point tariff. The Commission recognizes that the tariffs, as proposed in the NOPR, provide the opportunity for a customer to reserve certain valuable rights (*e.g.*, the right to short-term firm service during peak periods) while avoiding in part the long-term costs of the system (perhaps by relying on non-firm service during lengthy off-peak periods when there is a substantially reduced chance of interruption). However, the Commission has a countervailing concern that the transmission provider should not be able to withhold valuable transmission capacity from potential customers if that capacity is not being used by those who are paying for the long-term costs of the system.

Accordingly, the Final Rule pro forma tariff provides a mechanism to address this concern while safeguarding the rights of potential customers to obtain access to unused capacity. The tariff provides that reservations for short-term firm point-to-point service (less than one year) will be conditional until one day before the commencement of daily service, one week before the commencement of weekly

service, and one month before the commencement of monthly service. These conditional reservations may be displaced by competing requests for longer-term firm point-to-point service. For example, a reservation for daily firm point-to-point service could be displaced by a request for weekly firm point-to-point service during an overlapping period. Before the applicable reservation deadline, a holder of a conditional firm point-to-point reservation would have the right of first refusal to match any longer-term firm point-to-point reservation before being displaced. After the deadline, the reservation becomes

[31,747]

unconditional, and the service would be entitled to the same priorities as any long-term point-to-point or network firm service.[456]

The Final Rule pro forma tariff does not propose point-to-point or network service with various degrees of firmness beyond the simple categories of firm and non-firm. When a customer requests firm transmission service, reservation priorities are established based first on availability, and in the event the system is constrained, based on duration of the underlying firm service request; customers may choose the "firmness" of service they want by electing to take non-firm service, or by reserving and paying for firm service. We have not included any degrees of firmness in the Final Rule pro forma tariff because having intermediate categories of firmness under point-to-point or network service would, we believe, unnecessarily complicate the priority system. However, utilities are free to propose and fully support different reservation priority provisions for firm service in subsequent rate filings as long as those provisions are not

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[456] The service itself, as opposed to reservations, is subject to the curtailment provisions discussed below.

unduly discriminatory, fully comply with the principles of comparability, and are priced appropriately.

c. Reservation Priorities for Non-firm Service

Comments

IOUs, state commissions, and potential network customers tend to support the service reservation priorities for non-firm service set forth in the NOPR pro forma tariffs (i.e., transmission service by network customers for economy purchases to serve network load has a higher priority than non-firm point-to-point service, which has a higher priority than a firm point-to-point customer using transmission service at secondary points of receipt and delivery). However, because network customers pay a higher rate than point-to-point customers, these commenters argue that network customers should be permitted to use their off-peak load ratio share of the transmission system to make off-system sales. Many commenters argue that point-to-point customers can use their secondary service for both purchases and sales; thus, they believe it is discriminatory to limit network customers to purchases at secondary points.

Commenters that are opposed to the service reservation priority scheme in the NOPR pro forma tariffs argue that transmission providers will discriminate against third party users in favor of their native load economy purchases. These commenters argue that all non-firm service should have equal priority.

Other commenters, such as CINergy, would base priority on the duration of service. CINergy claims that this method would eliminate what it claims is an advantage (over network) given in the NOPR to point-to-point service in making short-term purchases. TVA notes that it establishes priority for non-firm service based on duration of service requested, with customers in each service category receiving priorities based on the rate they wish to pay.

Some commenters believe that the transmission price should affect the priority of customers to obtain non-firm transmission capacity.[457] However, other commenters argue that this seems to be precluded by the NOPR pro forma tariffs' service priority provisions.

Although PSE&G believes that the NOPR pro forma tariffs suggest a first-come, first-served allocation method for capacity in excess of that needed for firm transmission service, it proposes a fixed period of time for all potential users to submit bids for service (*e.g.*, one week prior for monthly service), allowing the bid price to determine priority (*i.e.*, the higher bid prices receive service priority over lower bid prices). According to PSE&G, customers could bid an "up to" rate subject to a price floor, with all revenues flowed back to firm service customers. TVA also advocates departing from the first-come, first-served approach for allocating some uses of the transmission system, claiming that price is an effective means to establish priority for non-firm and short-term firm services.

Utility Wind Interest Group requests that non-firm service used for transmitting renewable resources be given a higher priority than non-firm service used

[31,748]

for transmitting conventional resources because renewable resources cannot store their fuel supply.

Commission Conclusion

We continue to believe that network economy purchases should have a reservation priority over non-firm point-to-point and secondary point-to-point uses of the transmission system. Network transmission customers are obliged to pay all of the costs of the transmission system without regard to the resources from which energy is scheduled. Therefore, it is

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457 *E.g.*, Duke, Orange & Rockland.

appropriate that the transmission associated with a network customer's economy purchases (i.e., transmission that is used to substitute one resource for another on an as-available basis) enjoys a higher priority than non-firm point-to-point transmission service.

Regarding the reservation priority for non-firm service under point-to-point service, we will adopt a reservation priority based upon duration of non-firm service, with price acting as a tie-breaker for competing service requests of an equal duration. If there is insufficient transmission capacity to accommodate all non-firm transmission requests, the reservation of longer duration should displace the shorter. For example, a reservation for a month of non-firm service will displace a reservation for a week of non-firm service. Also, a reservation for a week will displace a reservation for a day, which will displace a reservation for an hour of non-firm service. If a customer requests non-firm and later another customer requests longer-term non-firm service before either term of service begins, the first customer to request service has the right of first refusal to change its request to the longer term of service. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest reservation priority.

3. Curtailment Provisions

a. Pro-rata Curtailment Provisions

Comments

A large number of IOUs that are control area operators argue for discretion to curtail the transaction that most effectively relieves the constraint, in lieu of mandatory pro-rata curtailments, which they argue are inappropriate and not cost effective.

Other commenters that do not support pro-rata curtailment argue that preference should be given to native

load or existing customers because these customers have paid the majority of the costs of the transmission system. A large number of customers note that their existing contracts contain "enhanced" curtailment priorities (*i.e.*, service to others will be curtailed before service to customers with such curtailment priority) due to the large capital outlays made by them in connection with their service.[458]

Public Generating Pool believes that the proposed curtailment provisions may not be flexible enough for transactions in the Northwest. It argues that hydro spill should be avoided, and suggests that transactions from federal and/or non-federal hydroelectric generation facilities should not be curtailed pro rata with other transactions that do not rely on such facilities. Public Generating Pool urges that regional agreements (*e.g.*, regional transmission group agreements) that would achieve this goal should be given deference.

Other commenters support pro-rata curtailments for firm service.[459] PSNM states that this has been its operating practice in the past, and PSNM expects to continue such an approach in the future.

Power marketer commenters generally support the pro-rata curtailment adding that a standardized curtailment priority applied nationally would provide greater open access and eliminate discriminatory curtailments.

Commenting on a related subject, EEI maintains that the network tariff provision for termination of service in the event a customer fails to curtail load[460] may not be realistic for service to a Transmission Dependent Utility. EEI suggests that the Commission supplement this provision with

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458 *E.g.*, TANC, Turlock, SMUD.

459 *E.g.*, PSNM and Nebraska Public Power District.

460 Proposed Pro Forma Network tariff section 9.7—System Reliability.

a substantial penalty provision, coupled with an indemnification requirement.

[31,749]

Commission Conclusion

It was not our intent in the NOPR to require all transactions to be curtailed on a pro-rata basis regardless of whether the transaction relieves a constraint. We intended to permit curtailments of transactions that substantially relieve a constraint.[461] We intended and continue to believe that curtailment on a pro-rata basis is appropriate for curtailing the transactions that substantially relieve the constraint. In order to allay the concerns of the commenters addressing this issue, we are clarifying the curtailment provision of the tariff to explicitly allow the transmission provider discretion to curtail the services, whether firm or non-firm, that substantially relieve the constraint. Of course, any curtailment must be made on a non-discriminatory basis, including curtailment of the transmission provider's own use of the transmission system. Customers that believe the curtailment policy is administered unfairly may file a section 206 complaint at the Commission.

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[461] The Final Rule pro forma tariff contains language allowing the transmission provider the discretion to interrupt firm transmission service in an emergency or other unforeseen condition in a manner suggested by these commenters. Section 11.6, Curtailment of Firm Service, of the Final Rule pro forma tariff provides:

> However, the Transmission Provider reserves the right to interrupt, in whole or in part, firm Transmission Service provided under this Tariff when, in the Transmission Provider's sole discretion, an emergency or other unforeseen condition impairs or degrades the reliability of its transmission system.

The reference to curtailments being allocated on a proportional (pro rata) basis addresses situations where multiple transactions could be curtailed to relieve a constraint.

Concerning the request of certain Pacific Northwest commenters, we would consider granting deference to an alternative curtailment method to avoid hydro spill if such a regional practice is generally accepted and adhered to across the region, as discussed further in Section IV.K.

Finally, we agree with EEI's observation that terminating network service under the tariff to a transmission dependent utility that fails to curtail load as required may not be appropriate. As a result, we clarify that under network and point-to-point service, the transmission provider may propose a rate treatment (penalty provision) to apply in the event a customer fails to curtail load as required under the Final Rule pro forma tariff. Such proposals will be evaluated on a case-by-case basis on compliance.

b. Curtailment Provisions for Non-Firm Service

Comments

A number of commenters seek clarification of the curtailment provision for non-firm service under the two tariffs. They note that economy purchases by the network customer are accorded a higher curtailment priority than non-firm service under the point-to-point tariff. However, under the point-to-point tariff there is no acknowledgement of this higher priority for network service. Curtailments for non-firm transmission service under the point-to-point tariff are simply based upon duration of service, without reference to a higher priority for network economy purchases.

A number of commenters, including Industrial Energy Applications, suggest that a price-based curtailment queue for non-firm transmission will facilitate economy energy deals in highly competitive wholesale power supply markets and allow the parties to directly address delivery risk through the pricing mechanism.

Blue Ridge argues that the final rule should provide equal curtailment priority for all types of non-firm

transmission service. Utilities For Improved Transition argues that network customers should be able to transmit non-firm power imports under the network tariff with the same curtailment priority that is assigned to all other firm network uses of the transmission system.

A number of commenters note that the tariffs allow non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. These commenters contend that, under this requirement, curtailment of non-firm service is unlikely.[462] As a result, they believe that non-firm service is elevated to firm service. To remedy this situation, these commenters argue that transmission providers should have the ability to

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curtail non-firm service for any economic reason.

Commission Conclusion

We have clarified in the Final Rule pro forma tariff that a network customer's economy purchases have a higher curtailment priority than non-firm point-to-point transmission service.

A higher curtailment priority should be provided to network economy energy purchases for the reasons stated in *AES Power, Inc.*[463] In that case, we recognized that the network transmission customer has already "paid" for the transmission of its economy purchases (*i.e.*, transmission that is used to substitute one resource for another on an as available basis) through its payment of a load ratio share of the system.

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[462] *E.g.*, Florida Power & Light Company, Southern California Edison Company.

[463] 69 FERC ¶61,145, at p. 62,300 (1994) (proposed order), 74 FERC ¶61,220 (1996) (final order).

Many commenters oppose the point-to-point service provision allowing non-firm service to be interrupted only for emergency or reliability reasons or to provide firm service. Upon further consideration, we agree that this provision is too narrow. Accordingly, the Final Rule pro forma tariff is revised to allow the transmission provider to curtail non-firm service for reliability reasons or economic reasons (*i.e.*, in order to accommodate (1) a request for firm transmission service, (2) a request for non-firm service of greater duration, (3) a request for non-firm transmission service of equal duration with a higher price, or (4) transmission service for economy purchases by network customers from non-designated resources.). However, all curtailments must continue to be made on a non-discriminatory basis including curtailments of the transmission provider's own non-firm uses of the transmission system under the tariff. A firm point-to-point customer's use of transmission service at secondary points of receipt and delivery will continue to have the lowest curtailment priority.

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4. Future Filings

We recognize that there may be circumstances in which a public utility believes that the Final Rule pro forma tariff does not provide sufficient flexibility or that the utility can propose superior non-rate terms and conditions. Thus, once the compliance tariff and conforming rates go into effect, which will be 60 days after publication of this Rule in the *Federal Register*, a public utility (either Group 1 or Group 2) may file pursuant to section 205 a tariff with terms and conditions that differ from those set forth in this Rule, provided that it: (1) serves a copy of its filing on all wholesale customers for whom it has provided transmission service since March 29, 1995 (the date of the Open Access

NOPR) and on the state agencies that regulate public utilities in the states where those customers are located; (2) identifies all deviations from its compliance tariff in its letter of transmittal; (3) provides, to the extent practical, a redlined version of the tariff; and (4) demonstrates that such terms and conditions are consistent with, or superior to, those in the compliance tariff. However, it may not seek to litigate fundamental terms and conditions set forth in the Final Rule.[514] In addition, the public utility may file whatever rates it believes are appropriate, consistent with the Transmission Pricing Policy Statement.

5. Waiver

Finally, as noted above, several commenters propose that public utilities that own few transmission facilities be granted waiver, or that application of the Rule to such utilities be deferred until 60 days after they receive a section 211 request. As discussed more fully in Section IV.K.2., we find that it is reasonable to permit certain public utilities for good cause shown to file, within 60 days after this Rule is published in the *Federal Register*, requests for waiver from some or all of the requirements of this Rule. The filing of a request in good faith for a waiver from the requirement to file an open access tariff will eliminate the requirement that such public utility make a compliance filing unless thereafter ordered by the Commission to do so. It will not, however,

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[514] As we stated in our "Further Guidance Order," American Electric Power Service Corp., 71 FERC ¶61,393, 62,539-40, *order on rehearing*, 72 FERC ¶61,267, *order on rehearing*, 74 FERC ¶61,013 (1995), all tariffs need not be "cookie-cutter" copies of the Final Rule tariff. Thus, under our new procedure, ultimately a tariff may go beyond the minimum elements in the Final Rule pro forma tariff or may account for regional, local, or system-specific factors. The tariffs that go into effect 60 days after publication of this Rule in the *Federal Register* will be identical to the Final Rule pro forma tariff; however, public utilities then will be free to file under section 205 to revise the tariffs, and customers will be free to pursue changes under section 206.

exempt such public utility from providing, upon request, transmission services consistent with the requirements of the Final Rule.

I. Federal and State Jurisdiction: Transmission/Local Distribution.

In the original Stranded Cost NOPR, the Commission clarified that it has exclusive jurisdiction over unbundled retail transmission in interstate commerce by public utilities: it found that the Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, up to the point of local distribution. In the Open Access NOPR, the Commission reaffirmed this jurisdictional determination[515] and also

[31,771]

addressed the distinction between transmission and local distribution. The Commission stated three reasons for expressing its views on the distinction between Commission-jurisdictional transmission in interstate commerce and state-jurisdictional local distribution, in the context of unbundled retail wheeling by public utilities.[516] First, facilities that can

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[515] That determination included the situation in which a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In that scenario, the commission would have jurisdiction over all of the transmission facilities used for the unbundled wheeling provided by the intervening public utilities. The NOPR also noted that the Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale. *FERC Statutes and Regulations* ¶ 32,514 at p. 33,144.

[516] The term "wheeling" is intended to cover any delivery of electric energy from a supplier to a purchaser, *i.e.*, transmission, distribution, and/or local distribution. The Commission also has jurisdiction to order wholesale transmission services in either interstate or intrastate commerce

be used for wholesale transmission in interstate commerce by a public utility would be subject to the Commission's open access requirements. Second, states have authority to address retail stranded costs and stranded benefits through their jurisdiction over facilities used in local distribution. Third, as the structure of the industry continues to change dramatically, utilities need to know which regulator has jurisdiction over which facilities and services in order to meet state and federal filing requirements. Accordingly, the NOPR set forth our jurisdictional analysis and several technical factors, for determining what constitutes "facilities used in local distribution."

For unbundled wholesale wheeling, the NOPR proposed to apply a functional test, *i.e.*, whether the entity to whom the power is delivered is a lawful reseller. For unbundled retail wheeling, the NOPR proposed to apply a combination functional-technical test that would take into account technical characteristics of the facilities used for the wheeling. The Commission proposed seven indicators of local distribution to be evaluated on a case-by-case basis:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

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by transmitting utilities that are not also public utilities. *See Tex-La Electric Cooperative of Texas, Inc.*, 67 FERC ¶61,019 (1994), *reh'g pending*.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.[517]

The NOPR concluded that the application of these tests will enable states to address stranded costs by imposing an exit fee on departing retail customers, or including an adder in the retail customers' local distribution rates.[518]

In the NOPR, the Commission also addressed buy-sell transactions in which an end user arranges for the purchase of generation from a third-party supplier and a public utility transmits that energy in interstate commerce and re-sells it as part of a "nominal" bundled retail sale to the end user. We explained that the retail sale is actually the functional equivalent of two unbundled sales (one transmission and the other the sale of power) and that we have exclusive jurisdiction over the voluntary sale by public utilities of unbundled transmission at retail in interstate commerce.[519]

Comments

Several commenters support the Commission's proposed jurisdictional demarcation.[520]

[31,772]

San Diego G&E states that the Commission correctly proposed to look at both functional factors (such as whether the service is retail or wholesale) and technical factors (such

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[517] *FERC Statutes and Regulations* ¶32,514, at p. 33,145.

[518] *Id.* at pp. 33,144-45.

[519] As discussed *infra*, there also would be a component of local distribution in such a transaction that would be subject to state jurisdiction.

[520] *E.g.*, PG&E, Wisconsin Coalition, Com Ed.

as voltage). PG&E states that the NOPR's functional/technical test is preferable to a bright line voltage test.

Consumers Power states that the Commission has exclusive jurisdiction over all wheeling on an interconnected interstate transmission grid. It suggests that the Commission and the states act through a joint board or hearing to resolve jurisdictional differences and develop a bright line test.

PSE&G and PG&E express concern that if retail wheeling is implemented, there may be loopholes that would enable customers to evade state jurisdiction and thus avoid paying stranded costs. For example, PSE&G is concerned that a retail customer may request transmission service only and a state commission will be unable to attach a retail stranded cost surcharge to that customer. PG&E proposes adding another indicator to the functional/technical test—a final tap to a retail customer—to ensure that "high-voltage" retail customers do not evade the state's reach. Moreover, to ensure that retail customers cannot escape state jurisdiction, PG&E recommends that the Commission state, as a matter of policy, that *all* retail customers taking retail transmission service from their host utility, *by definition* take service over local distribution facilities."

CINergy agrees with the Commission that a distinction between transmission and local distribution is important, but emphasizes the practical need for clarity on a timely basis. To achieve certainty, CINergy proposes that the Commission allow public utilities to file, under section 205, classifications of their facilities as transmission or local distribution. CCEM endorses CINergy's proposal. Although NARUC disagrees that the Commission has jurisdiction over unbundled retail transmission, if the Commission reaffirms the NOPR regarding its jurisdiction, then NARUC supports CINergy's proposal.

PSE&G strongly supports the Commission's proposed case-by-case methodology for determining whether facilities should be classified as transmission or local distribution. SoCal Edison argues that since a utility may have difficulty determining which of its facilities are transmission and which are local distribution, utilities and states should be able to ask the Commission to classify a particular facility. Portland and Orange & Rockland suggest that the Commission provide a forum to resolve disputes over the correct classification of particular facilities.

Ohio Edison states that the Commission should assume jurisdiction over unbundled retail transmission, but only where a state has required this unbundling. It also believes that the Commission should assert jurisdiction over the ancillary services necessary to provide this jurisdictional service.

NYSEG argues that the Commission lacks jurisdiction over the transmission component of bundled retail service. On the other hand, NYSEG argues that the statute, legislative history, and case law reveal that the Commission has jurisdiction over unbundled retail wheeling from source to load, since it is transmission in interstate commerce. NYSEG argues that the "local distribution" exception to the Commission's jurisdiction applies only to bundled sales of power at retail.

Several state commissions assert that states have rate authority over all facilities used to provide retail service.[521] IL Com argues that states have rate authority over all facilities used to provide retail service, regardless of whether the NOPR would classify these facilities as transmission or local distribution.

MI Com, citing *Connecticut Light & Power Company v. Federal Power Commission*, 324 U.S. 515 (1945) CL&P),

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[521] *E.g.*, NM Com, NC Com, AZ Com.

and *Arkansas Electric Cooperative v. Arkansas Public Service Commission*, 461 U.S. 375, 393-94 (1983), contends that states have plenary jurisdiction over all aspects of retail service, including retail access and unbundled retail transmission service. It asserts that the Commission's effort to expand federal jurisdiction into transmission in connection with retail sales is without statutory justification.

Legal Environmental Assistance argues that the NOPR creates confusion about, and may intrude onto, state jurisdiction.

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NYMEX argues that when a state orders retail wheeling, the state should have jurisdiction over that transmission-only service.

Oklahoma G&E, citing *CL&P* and *United States v. California Public Utilities Commission*, 345 U.S. 295, 316 (1953), asserts that the Commission failed to explain that the term "transmission in interstate commerce" could have different meanings depending on the factual context in which the term is applied. It argues that "transmission in interstate commerce" means the movement, in bulk, of electric energy flowing in interstate commerce, as opposed to the movement of electric energy that has been subdivided for delivery to consumers.

Oklahoma G&E further argues that "[t]he distinction between interconnected operation and radial operation corresponds precisely to this distinction between activities that have potential interstate effects and those that might have interstate effects but are a matter of primarily local concern."[522] Oklahoma G&E also disagrees that the transportation of electric energy sold at wholesale necessarily constitutes transmission in interstate commerce. It argues that

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[522] Oklahoma G&E Initial Comments at p. 16.

the Commission has misapplied case precedent and, by focusing on the level of the associated power sale, the Commission has misunderstood what constitutes a functional distinction between transmission in interstate commerce and local distribution.

NY Com asserts that the grant of jurisdiction to the Commission over wholesale power transactions in interstate commerce under section 201 of the FPA does not reduce the states' authority over local distribution (citing *CL&P* and *Federal Power Commission v. Florida Power & Light Company*, 404 U.S. 453, 467 (1972)). NY Com argues that the NOPR's assertion of exclusive jurisdiction over all facilities used to deliver electricity for resale, even those traditionally regarded as local distribution, violates Congress' assignment of local electric distribution to the states. It takes issue with the Commission's list of factors and says that states and the Commission should agree on a definition that preserves the traditional classification of local distribution facilities. According to NY Com, such definition should focus on the functional characteristics of local electric systems—*i.e.*, electricity flows into a comparatively restricted geographic area and does not flow back out of that area, and the power is consumed in that area.

NY IOUs argue that the Commission has jurisdiction over unbundled, but not bundled retail wheeling. It says that other factors, including the indicators listed in the NOPR, are irrelevant, and that even long-distance interstate transmission is under state jurisdiction as long as it is bundled with a retail sale. According to NY IOUs, this is the plain meaning of the FPA; resort to legislative history is unnecessary. NY IOUs bases this view on section 201(a), which says that federal regulation extends only to matters not subject to state regulation. NY IOUs says that the only matters subject to state regulation were bundled retail sales, and that since transmission was part of the bundle, Congress intended transmission to stay under state authority as long as it is part

of that bundle. It also cites section 201(b), which sets forth exceptions from Commission jurisdiction, and section 201(c), which defines "transmission in interstate commerce" and thus also controls the definition of transmission in intrastate commerce. Finally, NY IOUs argues that the legislative history supports its view, as does the case law.

Central Louisiana believes that the costs of requiring a transmission provider to take unbundled transmission service for both wholesale and retail purposes would far exceed any benefits. In this regard, Central Louisiana says that states clearly have jurisdiction over bundled retail transmission charges and that the proposed approach could not be implemented without states giving up jurisdiction or the passage of new federal legislation.

MN DPS disagrees on legal and policy grounds with the Commission's assertion of jurisdiction over unbundled retail transmission services.[523] It maintains that the Commission's arguments do not negate the language of the FPA specifying that regulation of retail sales of electric energy is reserved to the states. MN DPS argues that the Commission's arguments

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in support of its position are not on point because the issue is state authority to set rates for retail sales, not interstate commerce. Further, it declares that jurisdiction over a service does not change simply because it is priced differently.

Several commenters argue that unbundled pricing should not expand the Commission's jurisdiction.[524] NARUC argues that the NOPR did not explain why the Commission's authority attaches only to unbundled retail transmission service, why unbundling is jurisdictionally significant, and how transmission of electricity to end users differs from

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523 *See also* OH Com.

524 *E.g.*, DOD, NM Com, KY Com, ABATE.

unbundled interstate transmission of natural gas by local distribution companies, which is subject to state regulation. Thus, NARUC urges the Commission not to claim jurisdiction over unbundled retail transmission services.

NARUC also argues that the Commission's test for distinguishing between transmission and local distribution is not a bright line as discussed in *Federal Power Commission v. Southern California Edison Company*, 376 U.S. 205 (1964) (Colton). NARUC concludes that when a state determines to enable a retail customer to purchase power from a third-party provider, that state retains the authority to regulate the delivery service provided by the utility.

IL Com asserts that the test should be whether the utility function over which the Commission seeks to exercise jurisdiction is one which falls within the *Attleboro* gap.[525] It argues that the Commission has no legal authority to prescribe conditions under which a public utility may provide transmission service within its own service territory to its own retail customers. IL Com concedes that the court cases cited by the Commission can be interpreted to support widely disparate legal and policy positions, but argues that those cases resolved questions of Commission jurisdiction in circumstances where wholesale sales of electric power were being examined and not circumstances where retail sales are being considered. It contends that the question of whether the Commission should exercise jurisdiction over all transmission in retail wheeling has never been addressed before and requires a careful examination of the underlying purposes of Congress in enacting the FPA. IL Com explains that transmission by an Illinois utility of power to a retail consumer within its own service territory is not subject to Commission jurisdiction because that transmission was never

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[525] *See Public Utilities Commission v. Attleboro Steam & Electric Company*, 273 U.S. 83 (1927).

within the *Attleboro* gap and has always been regulated by states.

OK Com recommends that the Commission apply to the electric industry the same policy that it has adopted concerning its regulation of the gas industry and leave unbundled retail service regulation to state authorities.

WI Com argues that if a utility offers unbundled retail access, jurisdiction over transmission services should continue to be based upon the historical demarcation between wholesale and retail transactions. KY Com argues that Congress did not intend, by authorizing wholesale wheeling in the Energy Policy Act, to change the longstanding division of jurisdiction between the Commission and the states. It claims that the NOPR ignores the limitation in the FPA that the Commission has no jurisdiction over retail sales service. NV Com cites several cases noting the states' historical authority to regulate retail rates.

IA Com proposes a definition of local distribution and transmission that would preserve the jurisdictional status quo and does not put a state commission in the position of losing authority over certain elements of a retail transaction should it allow retail wheeling. IA Com's proposed definition is as follows:

Distribution—Service provided by a utility directly connected to an ultimate consumer of electricity is a distribution service with respect to electric energy delivered to that consumer.

Transmission—Service provided by a utility with respect to electric energy to be delivered to an ultimate consumer through another utility is a transmission service.[526]

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526 IA Com Initial Comments at p. 4.

Montana Power states that a reasonable way to give effect to the "local distribution" exemption is to define "local distribution" as a bundled retail sale, even if interstate facilities are used.

Several commenters criticized the NOPR's functional/physical indicators. PA Com disagrees with the Commission's discussion of the FPA's legislative history and asserts that the FPA does not address the issue of what constitutes local distribution. PA Com contends that the issue was resolved by the Supreme Court in *CL&P* in a manner contrary to the Commission's technical-functional test and that the NOPR minimized *CL&P*. NM Com asserts that the proposed engineering and functional elements for determining the status of local distribution facilities fail to account for the governmental or legalistic test requirement of the FPA as identified in *CL&P*.

KY Com concludes that a physical definition of distribution facilities, based on objective criteria, is consistent with the FPA and is necessary to provide a clean line of demarcation.

CO Com argues that Congress used a transactional test rather than a functional test and that Congress intended all retail transactions to be under state jurisdiction. According to CO Com, there is concurrent jurisdiction over unbundled transmission in interstate commerce to an end-user. Moreover, CO Com asserts that unbundled intrastate transmission to a wholesale purchaser is under state jurisdiction (citing section 201(b)(1)). Finally, CO Com argues that the state has authority over unbundled transmission in intrastate commerce to an end-user when the transmission-providing utility, end-user, and generator are all within the same state.

Other commenters prefer a functional test. Natural Resources Defense, DOE, and Sustainable Energy Policy generally agree that a line needs to be drawn between

transmission and local distribution but believe that the Commission's test is unnecessarily cumbersome or may lead to legal uncertainty, at least within the context of stranded benefits. Instead, Natural Resources Defense proposes the following functional test, which is based on end-use service:

The Federal Power Act does not affect state regulators' jurisdiction to apply distribution charges—either volume-based or fixed—to electricity that is used by any utility customer to provide end-use services (as distinguished from electricity that is purchased for resale to end-use customers).[527] Sustainable Energy Policy endorses Natural Resources Defense's position. DOE suggests that a functional definition of local distribution (*i.e.*, electricity provided for end-use service) may be the best way to avoid legal uncertainty.

EPA argues that the Commission's proposed physical definition may encourage gaming to avoid stranded costs and costs associated with public policy goals such as energy efficiency, renewable energy development and R&D funding, and a physical definition assumes that power flows into, and not out of, distribution systems, which would not allow for distributed generation (*e.g.*, fuel cells). Thus, EPA urges the Commission to adopt a functional definition that "local distribution occurs whenever electricity is provided by a utility for end-use service." Alternatively, EPA suggests that the Commission add a provision to its approach that "the provision of electricity for end-use service generally involves local distribution." Sustainable Energy Policy suggests a non-bypassable charge levied on all users of the distribution system. It endorses the policy formulation set forth by Natural Resources Defense in its initial comments. Reynolds wants to ensure that there is always at least concurrent state jurisdiction over lines used to serve end-use customers, since only states can order retail wheeling.

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[527] Natural Resources Defense Initial Comments at p. 3.

Detroit Edison argues that state/federal jurisdictional issues should be resolved by focusing on the use of the facilities. It says that facilities that are used to distribute a utility's own power to its own local customers should be subject to state regulation, while the use of facilities for wholesale power transactions or wholesale or retail transmission in interstate commerce should be under federal regulation.

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Mountain States Petroleum Assoc argues that the Commission should use a functional test based on state boundaries: if a line is in more than one state, there is Commission jurisdiction; if a line is entirely within one state, there is state jurisdiction.

MD Com states that it believes that the Commission's proposed indicators for determining where to draw the line are adequate, but adds that it does not concede the Commission's assertion of jurisdiction over unbundled retail transmission.

Some commenters suggest that implementation of the NOPR's tests could have adverse consequences. NH Com objects to the NOPR's specific tests; for example, if the Commission asserts jurisdiction over facilities because they are not radial, New Hampshire's policy of encouraging looping rather than radial lines would have the ironic effect of destroying state jurisdiction. NJ BPU states that there may be situations when the NOPR factors would not produce the proper result. It requests that the final rule recognize the need for case-by-case flexibility in determining where federal jurisdiction ends, so that the Commission and the states can work cooperatively.

NRRI argues that the NOPR's test could make siting of new transmission lines more difficult because states have in the past required native load customers to pay that part of the transmission-related revenue requirement that is not covered

by unbundled transmission service. NRRI contends that, if the Commission asserts jurisdiction over all unbundled transmission service and if there is a firm point-to-point service capacity right that has value and is reassignable, then state commissions might eliminate portions of the transmission systems subject to capacity rights from rate base. NRRI is also concerned that the NOPR's transmission/local distribution test could create a price squeeze between bundled and unbundled retail transmission rates.

IN Com argues that the NOPR's view of jurisdiction would discourage retail wheeling. It says that states will be reluctant to order wheeling if the result is that they lose jurisdiction over the previously rolled-in transmission aspect of the service. It suggests that the Commission use negotiated rulemaking to address jurisdictional issues.

Several commenters suggest alternative approaches to jurisdictional line-drawing. NV Com suggests that the Commission consider federal and state jurisdiction over transmission by using "network" and "non-network" concepts:

The "network" concept for regulation recognizes that there is an interstate network of electric facilities used to link generation with loads. The operation of that network is indifferent to whether the electrical flows are retail or wholesale flows. Conceptually, events on the network could fall under federal jurisdiction. Where facilities provide essential service for the delivery of power, but do not substantially affect the electrical flows on the network, the facilities fall outside the network and would remain within the traditional domain of the state commission. As a consequence the delineation of federal and state jurisdiction evolves from the recognition of the events and where they

occur as opposed to a rigid consideration of the physical properties of the facilities involved.[528]

NV Com further explains that the determination of what is a network event would require a case-by-case examination.

OH Com asserts that Congress intends there to be a bright line between state and federal jurisdiction and that the Commission has failed to provide such a bright line. OH Com proposes the use of retail marketing areas to provide the bright line—the jurisdictional line would be at the point at which power enters the retail marketing area of the entity delivering the power to the retail customer. OH Com cites section 212(g) of the FPA, as amended by the Energy Policy Act, which provides that the Commission cannot issue any order under the FPA inconsistent with state law governing retail marketing areas.

Under OH Com's proposal, the Commission would have jurisdiction over the wheeling-out and wheeling-through components of retail wheeling and the state would have jurisdiction over the wheeling-in component due to its local nature. OH Com concludes that the Commission's approach "fails to meet the legal standard

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FERC must consider, and is inconsistent with the 'savings clause' and legitimacy of 'retail marketing areas' as discussed in the amended FPA."[529] OH Com also explains that the Commission's approach "is wreaking havoc on the state's ability to develop an interruptible buy-through arrangement to provide an increased competitive option for its retail customers."[530] OH Com further encourages the use

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528 NV Com Reply Comments at p. 3.

529 Sections 212(g) and 212(h) of the FPA.

530 We note that since OH Com filed its comments, it approved an interruptible buy-through plan. *See Interruptible Electric Service*

of mutual deference to promote Congress' intent in mandating a system of federal/ state cooperation. In support, OH Com cites federal and state enforcement of telecommunications laws. NRRI also suggests that the jurisdictional line be drawn at the retail marketing area.

DC Com argues that the NOPR test is too difficult to administer and will create problems in determining the rate base at the state level. It suggests that the Commission should have jurisdiction over transmission from the source to the boundary of the "home" utility that delivers the power to the customer, with state jurisdiction over all aspects of the transmission service within that utility's franchise territory. AZ Com also expresses doubts that the NOPR's test is workable.

Several commenters propose that the Commission and state authorities address the jurisdictional issue jointly. SBA characterizes the Commission's proposed demarcation line as "laudable but misguided."[531] SBA recommends that a federal/state board be established to resolve the transmission/local distribution dilemma, similar to what Congress did for allocating costs between interstate and intrastate communications. SBA explains that the problem in the communications industry was the impossibility of

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Guidelines, Case No. 95-866-EL-UNC,—PUR 4th—(Ohio PUC Feb. 15, 1996). *See also Central Illinois Light Company*, Docket No. ER96-1075-000 (1996) (accepting amendment to open access transmission tariffs that expands service eligibility to accommodate participation in experimental retail wheeling pilot program approved by the Illinois Commerce Commission); *Illinois Power Company*, Docket No. ER96-1285-000, 75 FERC (1996); *cf. Illinois Power Company*,—PUR4th—, No. 95-0494 (Illinois Commerce Commission Mar. 13, 1996) (offering retail direct access service providing transmission and ancillary services using the rates, terms, and conditions of Illinois Power's open access tariff on file with the Commission); recently introduced legislation in Rhode Island, H.B. 8124, the Utility Restructuring Act of 1996.

[531] SBA Initial Comments at p. 36.

allocating a portion of a single copper wire to interstate or intrastate service.

AZ Com notes that even if the Commission is correct, the FPA clearly does not preempt a state from concluding that retail transmission or other direct access programs should be implemented in that state. AZ Com suggests that there may be concurrent jurisdiction and that mutually agreed-upon principles should be implemented to determine which jurisdiction should be given deference.

MD Com states that in determining the status of particular facilities, the Commission should give substantial weight to determinations made by states. ABATE states that the Commission could initially defer to states with respect to the determination of rates, terms, and conditions, while maintaining the right to review and overturn the state determination.

If the Commission maintains its position concerning jurisdiction, NARUC argues that the Commission should not implement its multi-factor test, but should enter into discussions with state commissions to develop workable alternatives. NH Com argues that pricing the retail part of a transaction, even if it involves use of the transmission system, should be subject only to state jurisdiction. NH Com wants to create a mechanism by which state and federal regulators combine their efforts in cooperative regulation; it suggests several alternatives such as state/federal agreements for shared jurisdiction.

KY Com and NRRI object to the statement in the NOPR that retail buy-through service is really transmission service (subject to the Commission's jurisdiction) plus a sale of generation at retail (subject to state jurisdiction). From a policy standpoint, KY Com argues that the Commission's approach creates a powerful disincentive for a state to embark on changes that otherwise might foster a more competitive environment. NRRI argues

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that the Commission's approach may violate sections 212(g) and 212(h).

IL Com is concerned that industrial customers who get direct access may attempt to evade state jurisdiction, and thus avoid retail stranded cost charges, by bypassing facilities such as radial lines. It contends that retail wheeling rate surcharges would be a more effective means of recovering retail stranded costs if states were allowed to apply them to unbundled transmission and local distribution rates, not just the local distribution component of such rates.

NC Com asserts that "[a] significant cottage industry may well arise solely to convert retail customers into wholesale customers, thereby subverting the intent of Congress as expressly set forth in EPACT."[532] If the Commission does not adopt NARUC's proposal, NARUC asserts that the Commission's functional test should not permit an end user to bypass the distribution service provided by the utility. It urges the Commission to assure that there will be some facility involved in the transaction that will be defined as providing a local distribution service.

NARUC also requests that the following sentence be added to proposed 18 CFR 35.27:

Nothing in this part limits the authority of a State commission in accordance with State law (1) to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission's jurisdiction, (2) to establish competitive procedures for the acquisition of such electric energy, or (3) to establish non-discriminatory fees for the delivery of such

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532 NC Com Initial Comments at p. 7.

electric energy to retail consumers for purposes established in accordance with State law.[533]

Duke is concerned about the potential for regulatory gaps, which could lead to costs not being recovered from either federal or state jurisdiction. Duke is also concerned that where facilities are used for both wholesale and retail transactions, costs might not be recovered if federal and state regulators use different methods of cost allocation.

In response to the NOPR's proposal for functional unbundling,[534] CA Com agrees that it is important to draw a distinction between transmission and local distribution and that a bright line is not possible, but suggests that corporate or functional unbundling might provide a means to establish a workable bright line without relying on the more qualitative approach proposed in the NOPR. Arizona argues that rather than unbundling transmission for retail purposes, each utility should establish a distribution function that would obtain transmission on behalf of retail customers, taking service under the utility's tariff. Arizona states that this would simplify the allocation of transmission costs, since all transmission costs would be under the Commission's jurisdiction. Arizona argues that the Commission should permit the utility to recover the distribution rate approved by the state. According to Arizona, this would create a bright line between state and federal jurisdiction.

TX Com argues that the proposed test would not be applicable to intrastate utilities in Texas because they do not operate in interstate commerce. Thus, it asserts that it should continue to regulate Electric Reliability Council of Texas (ERCOT) transmission and distribution service and deal with stranded cost issues that arise in connection with any retail wheeling initiatives.

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533 NARUC Reply Comments at p. 15-16.

534 *FERC Statutes and Regulations* ¶32,514, at pp. 33,080-83.

Several commenters object to the Commission's proposal to assert jurisdiction over transactions that are buy-sell transactions in name only.[535] AEP argues that the Commission should avoid an unnecessary conflict over state/federal jurisdiction that may be caused by the NOPR's statement that buy-sell transactions are in fact transmission subject to Commission jurisdiction. It suggests that the Commission attempt to reach agreement with the states on this matter or ask Congress for any necessary statutory change. Citizens Utilities also argues that the Commission should not unbundle the interstate transmission aspect of buy-sell transactions. It says that, unlike the analogous

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gas contracts, buy-sell arrangements on the electric side are not an end run around clear federal jurisdiction. Further, it argues that it would be very difficult to define those buy-sell transactions that truly belong under federal jurisdiction.

IL Com also objects to the NOPR's characterization of buy-sell transactions. It argues that the fact that a transaction becomes unbundled does not suddenly make part of it under federal jurisdiction. Nucor argues that there is no need for the Commission to resolve this issue now; it suggests that the buy-sell arrangement is only tangentially related to open access. It argues that each buy-sell transaction will have to be addressed individually.

UT Com seeks clarification as to what the Commission means by buy-sell arrangements:

we currently authorize interruptible "buy-through" contracts, through which a retail customer, taking service subject to interruption for either economic or technical reasons, can opt to "buy-through" an interruption. The public utility purchases energy on behalf of the customer and sells it at cost to the

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[535] *See id.* at p. 33,082.

customer. In our opinion, such transactions are not an example of a buy-sell transaction within the meaning of the proposed rule.[536]

DOD objects to the statement in the NOPR that "buy-sell" transactions are not really bundled retail service. It says that this view will discourage the development of innovative state programs, such as direct access programs. NYSEG also argues that buy-sell transactions are not under the Commission's jurisdiction. It argues that these transactions are unlike buy-sell transactions on the gas side, where the Commission asserted jurisdiction to prevent LDCs from circumventing the nondiscrimination standard it imposed on the release of capacity. NYSEG says:

In contrast to its regulation of gas buy-sells, if the Commission regulates electric buy-sell transactions it would forego regulation of a transaction in which the Commission has a significant interest (*i.e.*, access to the upstream seller's transmission), to regulate a transaction in which the Commission has virtually no interest (*i.e.*, access to the distributing utility's system). Electric utilities must serve each retail customer irrespective of whether the customer takes traditional bundled service or retail buy-sell service. Unlike excess upstream gas pipeline capacity, the capacity on the local utility's electric system would not be allocated to another customer in a FERC jurisdictional transaction absent the electric buy-sell transaction. Electric buy-sell transactions are not designed so as to manipulate the assignment of upstream transmission capacity. Consequently, the impetus for FERC to reclassify gas buy-sell transactions as capacity assignments is not present in the electric context.[537]

NYSEG argues that there are only two possible grounds for the Commission's assertion of jurisdiction over electric

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536 UT Com Initial Comments at p. 4-5.

537 NYSEG Initial Comments at p. 48 (footnote omitted).

buy-sell transactions: either (1) the sale for resale by the supplier is really a sale at retail to the end user, and the resale by the local utility is really unbundled retail wheeling; or (2) the Commission has jurisdiction over transmission service that is part of bundled retail service. It claims that the second ground is invalid because the transmission aspect of bundled retail service is distribution. It also claims that the first ground is invalid because it assumes that the sale by the supplier to the local utility is not a sale for resale even though the contract says that it is. NYSEG states:

The logical outcome would be that FERC would *not* have jurisdiction over the sale by the supplier to the utility, including transmission by that supplier because it would be a bundled retail sale. This is because, if the commission holds the resale to be a retail wheel, then it would have to find that the sale by the supplier is a retail sale to the end user. The Commission cannot at once regulate the sale for resale and the "retail transmission service." The Commission would regulate the transmission rates of the local franchise utility, although it would not regulate the access to such transmission service—a matter FERC leaves to state regulators. In the process, FERC

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would abandon the ability to regulate access to the supplier's bundled "retail power sale and transmission service," a transaction that FERC arguably has an interest in regulating.[538]

Finally, NYSEG argues that if the Commission insists on asserting jurisdiction, it should at least grandfather existing contracts.

UT Industrials state that where there is a state barrier to a buy-sell transaction, the Commission should allow the utility

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538 NYSEG Initial Comments at p. 50.

to file a tariff with the Commission that would permit the utility to complete a voluntary buy-sell transaction as the NOPR proposes. However, it contends that when a state regulatory authority is authorized to, and has approved buy-sell transactions, it is not necessary for the Commission to become involved. It urges the Commission to allow such transactions to take place free of Commission regulation.

Commission Conclusion

In the discussion below, the Commission addresses the following jurisdictional issues raised in the prior NOPRs:

a. Does the Commission have jurisdiction over unbundled transmission in interstate commerce by a public utility when such transmission is used to transport electric energy that is sold to an end user?

b. If so, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

c. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

d. What procedures are appropriate for making jurisdictional determinations?

In addition, the Commission addresses concerns raised by state regulators which indicate that competition and open access are perceived as threatening the traditional regulatory functions of state commissions. The Federal Power Act differentiates between state and federal regulation of electric power. As we discuss below, the Commission believes that any change in state or federal jurisdiction over physical transmission assets and related costs will not affect the traditional tasks of state and federal regulators.

The wide range of jurisdictional interpretations and proposals in the comments reflects the fact that the legislative history of the FPA and case law interpreting federal/state jurisdiction under that Act and the Natural Gas Act grew out of a market structure in which electricity and transmission generally were bought and sold on a bundled basis. As a result, most transactions included either a retail or wholesale sale of electric energy and jurisdictional lines were drawn on the basis of this sale. Thus, the cases simply do not resolve dispositively these jurisdictional issues when they arise in the context of the market structures and unbundled transactions being contemplated in today's electric industry. However, after reviewing the extensive analysis of the FPA, legislative history, and case law contained in both our initial Stranded Cost NOPR and in our Open Access NOPR, and the comments received on that analysis, we continue to believe that we were correct in asserting jurisdiction over the transmission component of an unbundled interstate retail wheeling transaction. We therefore reaffirm our conclusion. We also reaffirm and clarify our determinations regarding the tests to be used to determine what constitute Commission-jurisdictional transmission facilities and what constitute state-jurisdictional local distribution facilities in situations involving unbundled wholesale wheeling and unbundled retail wheeling.[539]

At the same time, the Commission strongly supports the efforts of states to pursue pro-competitive policies. We recognize that jurisdictional issues raise overlapping Federal and state policy concerns that call for heightened cooperation among federal and state regulators. As discussed below, where states unbundle

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[539] Not only do we conclude that our determinations are legally supportable under the case law, but we believe it is imperative to provide guidance to public utilities and state regulators as to our position on where the jurisdictional boundaries lie.

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retail sales, we will give deference to their determinations as to which facilities are transmission and which are local distribution, provided that the states, in making such determinations, apply the seven criteria discussed in the NOPR and reaffirmed below. In addition, we clarify our view that there is an element of local distribution service in any unbundled retail transaction, and further clarify other aspects of our jurisdictional ruling to preserve state jurisdiction over matters that are of local concern and will remain subject to state jurisdiction if retail unbundling occurs.

We first address our legal determination that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, this Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission. No commenter has raised cases or legislative history not previously considered in our prior NOPRs, and we will not repeat here our full legal analysis of this issue.[540] However, we find compelling the fact that section 201 of the FPA, *on its face*, gives the Commission jurisdiction over transmission in interstate commerce (by public utilities) without qualification.[541] Unlike our jurisdiction over sales of electric energy, which section 201 of the FPA specifically limits to sales at wholesale, the statute does not limit our transmission jurisdiction over public utilities to wholesale transmission.

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[540] The Commission's complete legal analysis on this issue, and on the related issue of what facilities are Commission-jurisdictional transmission facilities, and what are state jurisdictional local distribution facilities, are contained in Appendix G to this Rule.

[541] Section 201(b)(1) specifically exempts from Commission jurisdiction facilities used for transmission in intrastate commerce and transmission of electric energy consumed wholly by the transmitter. As a result, we have no jurisdiction over retail wheeling that occurs in Alaska, Hawaii and the Electric Reliability Council (ERCOT) portion of Texas since transactions in those areas are intrastate.

In response to those commenters (including NARUC) who argue that the Commission did not explain why its authority attaches only to unbundled, but not bundled, retail transmission in interstate commerce by public utilities, we believe that when transmission is sold at retail as part and parcel of the delivered product called electric energy, the transaction is a sale of electric energy at retail. Under the FPA, the Commission's jurisdiction over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of the power. However, the unbundled transmission service involves *only* the provision of "transmission in interstate commerce" which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation.

In asserting jurisdiction over unbundled retail transmission in interstate commerce by public utilities, the Commission in no way is asserting jurisdiction to order retail transmission directly to an ultimate consumer. Section 212(h) of the FPA clearly prohibits us from doing so. In addition, as stated in both the initial Stranded Cost NOPR and the Open Access NOPR, we do not address whether states have authority to order retail wheeling in interstate commerce. The Commission's assertion of jurisdiction is that *if* retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail wheeling program, the Commission has exclusive jurisdiction over the rates, terms, and conditions of such transmission and public utilities offering such transmission must comply with the FPA by filing proposed rate schedules under section 205.

The Commission clarifies that nothing in this jurisdictional determination changes historical state franchise areas or interferes with state laws governing retail marketing areas of electric utilities. Section 212(g) of the FPA prohibits Commission orders that would be inconsistent with such laws. However, we reject arguments made by some of the commenters

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that section 212(g) could somehow be construed to give states authority over the rates, terms, and conditions of unbundled interstate transmission within retail marketing areas.[542] While our jurisdiction cannot affect whether and to whom a retail electric service territory (marketing area) is to be granted by the state, and whether such grant is exclusive or non-exclusive, neither can state jurisdiction affect this Commission's exclusive jurisdiction over transmission in interstate commerce by public utilities.

In response to several of the commenters, we further clarify that the Commission's jurisdiction over the rates, terms, and conditions of unbundled retail transmission is no broader than our authority over transmission used for wholesale transactions, and will not affect matters otherwise

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[542] The legislative history of FPA section 212(g) and its predecessor, former section 211(c)(3), indicates that the provision was focused on not interfering with state laws governing retail service territories and not permitting Commission wheeling orders "for purposes of sale by a utility to an ultimate consumer who is within the service territory of another utility (other than the applicant) where such territory is established by or under State law, rule, or decision." *See* H.R. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 92 (1978), *reprinted* in 1978 *U.S. Code Cong. & Ad. News* 7797, 7826. Nothing on the face of section 212(g) or the legislative history of either the Energy Policy Act or PURPA indicates that the provision in any way affects the Commission's authority over rates, terms, and conditions of transmission in interstate commerce by public utilities.

left to the states by Congress.[543] The Federal Power Act recognizes that retail marketing areas are governed by state law. Moreover, we believe that states have authority over the *service* of delivering electric energy to end users. In exercising this authority, state regulatory commissions and state legislatures have traditionally developed social and environmental programs suited to the circumstances of their states. State regulation of most power production and virtually all distribution and consumption of electric energy is clearly distinguishable from this Commission's responsibility to ensure open and non-discriminatory interstate transmission service. Nothing adopted by the Commission today, including its interpretation of its authority over retail transmission or how the separate distribution and transmission functions and assets are discerned when retail service is unbundled, is inconsistent with traditional state regulatory authority in this area.

The Commission reiterates its strong interest in preventing any balkanization of the interstate power market. Although the Commission believes its Final Rule will accommodate retail competition, if it is offered voluntarily by a utility or ordered by a state, our policies relate only to the bulk power market and not traditional state regulation of the retail market.[544]

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[543] Among other things, Congress left to the States authority to regulate generation and transmission siting. *See* FPA sections 201(b) and 211(d)(1); Section 731 of the Energy Policy Act.

[544] This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges.

NARUC has requested that the Commission specifically clarify in §35.27 of its proposed rules[545] that nothing in our final rule limits the authority of a state commission "to allow or disallow the inclusion of the costs of electric energy purchased at wholesale in retail rates subject to such State commission jurisdiction." We will adopt NARUC's proposal with modification, but add it as a separate subsection. The Final Rule adopts a new §35.27(b) as follows:

Nothing in this part (i) shall be construed as preempting or affecting any jurisdiction a state commission or other state authority may have under applicable state and federal law, or (ii) limits the authority of a state commission in accordance with state and federal law to establish (a) competitive procedures for the

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acquisition of electric energy, including demand-side management, purchased at wholesale, or (b) non-discriminatory fees for the distribution of such electric energy to retail consumers for purposes established in accordance with state law.

With respect to the Commission's adoption of the Open Access NOPR's functional/technical tests for determining what facilities are Commission-jurisdictional facilities used for transmission in interstate commerce and what facilities are state-jurisdictional local distribution facilities, the case law supports a bright line for unbundled wholesale

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545 Section 35.27 of the proposed rules provided that any public utility seeking authorization to engage in sales for resale at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity first placed in service on or after 30 days from the date of publication of the Final Rule in the *Federal Register*. *FERC Statutes and Regulations* ¶32,514, at p. 33,154.

transmission, *i.e.*, transmission of electric energy that is being sold for resale. This is consistent with the bright line drawn by Congress to fill the *Attleboro* gap for regulating wholesale sales of electric energy. The case law also supports a bright line with respect to retail transmission by intervening utilities, *i.e.*, transmission by those utilities between the new retail generation supplier and the public utility that previously provided bundled retail service to the end user. However, despite many commenters' arguments to the contrary, we cannot divine such a bright line for unbundled retail transmission by the public utility that previously provided bundled retail service to the end user. In fact, the limited case law, including *CL&P* and *Colton*, supports a case-by-case determination.[546] Accordingly, we believe our technical test, with its seven indicators, will permit reasoned factual determinations in individual cases.

Although we are unable to draw the bright line for local distribution facilities that many commenters would like, we believe it is important to make two clarifications regarding local distribution in the context of retail wheeling. First, even when our technical test for local distribution facilities identifies no local distribution facilities for a specific transaction, we believe that states have authority over the *service* of delivering electric energy to end users. Second, through their jurisdiction over retail delivery services, states have authority not only to assess stranded costs but also to assess charges for stranded benefits, such as low-income assistance and demand-side management. Because their authority is over services, not just the facilities, states can assign stranded costs and benefits based on usage (kWh), demand (kW), or any combination or method they find

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[546] As noted, the Commission's detailed legal analysis is contained in Appendix G. We are particularly persuaded by the Supreme Court's statement that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. *See CL&P*, 515 U.S. at p. 534-35.

appropriate. They do not have to assign them to specific facilities.[547]

Thus, while we believe in most cases there will be identifiable local distribution facilities subject to state jurisdiction, we also believe that even where there are no identifiable local distribution facilities, states nevertheless have jurisdiction in all circumstances over the service of delivering energy to end users. Under this interpretation of state/federal jurisdiction, customers have no incentive to structure a purchase so as to avoid using identifiable local distribution facilities in order to bypass state jurisdiction and thus avoid being assessed charges for stranded costs and benefits.

Based on concerns raised by state commissions as well as some utilities, we have further determined that it is appropriate to provide deference to state commission recommendations regarding certain transmission/local distribution matters that arise when retail wheeling occurs. We also believe it is important to develop mechanisms to avoid regulatory conflict and to help provide certainty to utilities as to which regulator has jurisdiction over which facilities. These are discussed below.

Determining where to draw the jurisdictional line for facilities used in unbundled retail wheeling transactions will involve case-specific determinations that evaluate the seven local distribution indicators that we are adopting. We believe that the Commission should take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities that they regulate. Therefore, in instances of unbundled

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547 As noted above, states retain authority over state integrated resource planning, utility resource portfolios, and utility buy-side and demand-side decisions.

retail wheeling that occurs as a result of a state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities, and how to allocate costs for such facilities to be included in rates, provided that such recommendations are consistent with the essential elements of the Final Rule.[548] Moreover, we recognize that in some cases the Commission's seven technical factors may not be fully dispositive and that states may find other technical factors that may be relevant. We will consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities.

Some commenters have asked the Commission to provide a forum to prevent or resolve disputes over the correct classification of facilities as transmission or local distribution. As a means of facilitating jurisdictional line-drawing, we will entertain proposals by public utilities, filed under section 205 of the FPA, containing classifications and/or cost allocations for transmission and local distribution facilities. However, as a prerequisite to filing transmission/local distribution facility classifications and/or cost allocations with the Commission, utilities must consult with their state regulatory authorities. If the utility's classifications and/or cost allocations are supported by the state regulatory authorities and are consistent with the principles established in the Final Rule, the Commission will defer to such classifications and/or cost allocations.[549] We

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[548] In order to give such deference, we expect state regulators to specifically evaluate the seven indicators and any other relevant facts and to make recommendations consistent with the essential elements of the Rule.

[549] This should also alleviate some concerns about the potential for costs not being accounted for if the Commission and a state commission use different methods of allocating costs.

encourage public utilities and their state regulatory authorities to attempt to agree to utility-specific classifications and allocations that the utility may file at the Commission.

A number of commenters have asked the Commission to defer to state commission recommendations or decisions regarding rates, terms and conditions of unbundled retail transmission in interstate commerce by public utilities. Some have suggested that we set broad guidelines for such rates, terms, and conditions, and then allow states to actually implement the guidelines. While the Commission cannot simply turn over its jurisdiction for the states to implement, we understand the concerns raised by many state regulators and believe that deference to state commissions with regard to rates, terms, and conditions may be appropriate in some circumstances, as discussed below.

As we determined in the NOPR, when unbundled retail wheeling in interstate commerce occurs, the transaction has two components for jurisdictional purposes—a transmission component and a local distribution component. The Commission has jurisdiction over facilities used for the transmission component of the transaction, and the state has jurisdiction over facilities used for the local distribution component.[550] Thus, the rates, terms and conditions of unbundled retail transmission by a public utility must be filed at the Commission. When this occurs, we will generally expect unbundled retail wheeling customers to take service under the same FERC tariff that applies to wholesale customers. However, if the unbundled retail wheeling occurs as part of a state retail access program, it may be appropriate

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[550] As discussed above, even if there were instances where no local distribution *facilities* are used, we believe states have authority over the *service* of delivering electric energy to end users.

to have a separate retail transmission tariff[551] to accommodate the design and special needs of such programs. In such situations, the Commission will defer to state requests for variations from the FERC wholesale tariff to meet these local concerns, so long as the separate retail tariff is consistent with the Commission's open access policies and comparability principles reflected in the tariff prescribed by this Final Rule. In addition, rates must be consistent with our Transmission Pricing

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Policy Statement, and the guidance herein concerning ancillary services.[552]

A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffirm our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third-party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between Federal and state jurisdiction over

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551 *I.e.*, the tariff would be different from the tariff that applies to wholesale customers. Such tariff would still be filed with the Commission under FPA section 205.

552 In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. *See* FPA section 212(h).

transmission in interstate commerce and local distribution. We have attempted to address these issues in a way that provides for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding retail service territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

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Appendix C--Allegations of Public Utilities Exercising Transmission Dominance

I. Examples From Proceedings Before Administrative Law Judges

These are examples of allegations that various public utilities have refused to provide comparable service, either through refusals to wheel, dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to provide service priority equal to native load, or refusals to provide service flexibility equivalent to the utility's own use.

A. American Electric Power Service Corp. (AEP)

In 1993, AEP filed, on behalf of its public utility associate companies, an open access tariff that offered only firm point-to-point service with very limited flexibility. It did not offer network service, flexible point-to-point service, or non-firm service. Thus, it did not provide customers with the same flexibility that AEP itself has. Nor did it provide a service priority equivalent to that enjoyed by native load. The Commission set AEP's tariff for hearing and, on rehearing, held that in order not to be unduly discriminatory, the tariff had to offer comparable service. American Electric

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Power Service Corp., 64 FERC para. 61,279 (1993), reh'g, 67 FERC para. 61,168 (1994).

At hearing, Raj Rao of Indiana Michigan Power Agency (IMPA) (Ex. IMPA-1, Feb 23, 1994) and Kenneth Hegemann of American Municipal Power-Ohio, Inc. (AMP-Ohio) (Ex. AMPO-1, Feb 23, 1994), both senior management officials, testified concerning AEP's alleged discriminatory practices.[1] AMP-Ohio is an association of municipalities in Ohio, some of whose members depend on AEP for transmission and partial requirements service. IMPA is an association of municipalities in Indiana, and many of IMPA's loads are

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[1] After the Rehearing Order expanding the scope of the proceeding, AMP-Ohio and IMPA withdrew this testimony as no longer necessary. This withdrawal does not change the fact that the testimony was sworn to under oath.

captive to the AEP transmission system. The witnesses alleged as follows:

1. In anticipation of high peak demands, AEP would contract for large blocks of available short-term power, withhold sale of short-term power, refuse to transmit third party short-term power, and require purchases from AEP at the emergency rate (100 mill/kwh) when an emergency might not exist. Ex. AMPO-1 at 6.

2. In December 1989, AMP-Ohio negotiated a 20 MW purchase of short-term power from Louisville Gas & Electric Company (LG&E). AEP refused to wheel because LG&E had earlier that day told AEP it had no power to sell to AEP. AEP then bought the power from LG&E and offered to resell it to AMP-Ohio. Ex. AMPO-1 at 6-7.

3. In January 1990, AMP-Ohio solicited bids for February power purchases from a number of utilities including AEP. AEP was not the winning bid. AMP-Ohio made arrangements to purchase the power from four winning bidders and sought transmission through AEP. When AMP-Ohio gave AEP the schedule for delivery, AEP refused to transmit the power, matched the average price of the winning bids, and made the sale itself. Ex. AMPO-1 at 7.

4. In August 1993, an AMP-Ohio member (Columbus, Ohio) was purchasing 10 MW of hourly non-displacement power from AEP and, after AEP raised its price to 60 mills/kwh, sought another source for the next hour. Consumers Power Company and Detroit Edison Company both offered non-displacement power at 40 mills. AEP refused to transmit, saying it had a 600 MW unit out and could not resell power from another source.[2] Columbus

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[2] AEP generally limited its offer of short-term transmission to buy/sell transactions; that is, AEP would buy the power from the seller and resell it to the purchaser. Supplemental testimony of AEP Witness Baker (Ex. A-73) at p. 27-29. Often, the terms of the buy/sell transaction

cancelled the transaction and had to buy 10 MW of power from AEP at 100 mills/kwh. Ex. AMPO-1 at 7-8.

5. In July 1993, two AMP-Ohio members (Columbus and St. Mary's) had been buying hourly non-displacement power from AEP when the price rose to 35 mills. Dayton Power & Light Company (DP&L) offered to sell at 23 mills and AEP agreed to transmit for one hour. But for the next hour, AEP said it had problems with its system, refused to transmit the power, kept the power from DP&L for itself and offered to sell power to AMP-Ohio for Columbus and St. Mary's at 100 mills. Columbus increased its local generation, but St. Mary's purchased 8 MW at 100 mills. For the next hour, AMP-Ohio arranged with DP&L for another 8 MW, hoping AEP would transmit under the 24 hour buy-sell agreement. AEP did transmit this power. Seven hours later in the day, St. Mary's Greenup Hydro project power was available and the 8 MW from DP&L was no longer needed. If St. Mary's had been receiving the hourly power that AEP had refused to transmit, St. Mary's could have switched to Greenup power. But because AMP-Ohio had changed to daily service, St. Mary's had to pay a demand charge for the entire day, even though it used the power only 7 hours and would have paid less under the hourly rate. Ex. AMPO-1 at 8-9.

6. In January 1994, AMP-Ohio sought to transfer power from one member with generation to other members, which required transmission over AEP and Toledo Edison lines. Toledo Edison said yes, AEP said no. AMP-Ohio's northern members purchased emergency power from Toledo Edison. AMP-Ohio then reminded AEP that it had agreed not to deny transmission

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required transmission dependent utilities (TDUs) to maintain reserves and meet contractual commitments for at least a year. *Id.*

and AEP agreed to transmit. Ex. AMPO-1 at 9.

7. IMPA arranged to buy 80 MW of short-term power from LG&E and have it wheeled, using buy-sell arrangements, through Public Service Company of Indiana (PSI) and AEP to serve IMPA's load at Richmond (an IMPA member). The delivered price was $.292 per kW-day plus a 1 mill adder. At the same time AEP arranged to buy 300 MW from PSI at $.30 per kW day plus out-of-pocket energy costs. Hence, PSI was shipping a total of 380 MW to AEP with 80 MW of that amount to be delivered to IMPA's load at Richmond. Then, on a day when IMPA should have received the 80 MW, AEP told IMPA that PSI had sold everything to AEP and that IMPA would have to buy from AEP at $.63 per kW day plus the cost of energy from AEP. IMPA purchased from AEP under protest. AEP used its control over transmission to intercept the 80 MW at a lower price and resell it as short-term power to IMPA. AEP claimed that PSI had terminated its sales to AEP on that day. But the 80 MW was independent of PSI's other sales to AEP and would not have been interrupted if AEP had not interrupted it. IMPA-1 at 7.

8. IMPA has combustion turbines owned by and located at one member, which IMPA would like to connect to the Joint Transmission System owned by IMPA, CINergy and Wabash Valley Power Association. To do so, IMPA needed a metering agreement with AEP, to which AEP would not agree. IMPA-1 at 6.

9. In January 1994, IMPA had power to sell from its turbines when AEP and others needed power. IMPA offered power to AEP but AEP it said could not purchase the power without an existing contract. Moreover, since there was no short-term tariff, IMPA could not sell the power to another utility. IMPA-1 at 6.

10. Another example of the utility engaging in dilatory tactics that raised the customer's transaction costs and

effectively denied transmission is the "sham transaction" provision proposed by AEP. As filed, AEP's tariffs permitted it to deny service merely because a portion of the transmitted power might be used to serve a former retail customer of AEP. See, e.g., Ex. BR&WVP-1 (J. Bertram Solomon testimony, February 23, 1994). (As part of a settlement AEP filed the pro forma tariff and withdrew this provision.)

11. Finally, AEP's originally filed tariff contained a "prodigal customer" provision. Under this provision, transmission customers who sought to convert back to requirements service had to give AEP five years' notice, in which case AEP and the customer would enter into negotiations to determine whether AEP will provide service at all and if so under what rate, terms, and conditions. Ex. S-39 at 1 (Staff testimony). AEP did not require notice from all new customers, only from prodigal customers. Id. at 2. That a potential customer was previously served by AEP is not a reason to treat the customer differently. (AEP withdrew this provision when it filed the pro forma tariff.)

B. Entergy Services, Inc. (Entergy)

Entergy filed a partial settlement largely adopting the NOPR pro forma tariffs except for two provisions (headroom and ancillary services). Because the settlement predated the filing date for customer testimony before the ALJ, the customers did not address the need for Entergy to file a tariff. However, customers did make allegations of discriminatory practices, as follows.

1. Customers alleged that Entergy flat-out refused to wheel. Louisiana Energy and Power Authority (LEPA) witness Sylvan J. Richard testified that LEPA's predecessor systems could not obtain interconnections from Entergy. Ex. SJR-1 at 50.

2. Customers also alleged that Entergy refused to provide service priority equal to native load and refused to provide service flexibility equivalent to the utility's own use.

For example, LEPA witness Richard testified that even after state commissions ordered interconnections and other coordination services, LEPA's predecessors were still not able to obtain coordination services because Entergy was not willing to coordinate and because the transmission service it did offer was inflexible, unidirectional point-to-point service, which prevented economic coordination with others. Id. at 50-51.

3. South Mississippi Electric Power Association (SMEPA) witness J. Bertram Solomon testified that Entergy's original "open access" tariff was restricted to

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point-to-point service, proposed separate charges for each operating company, and required the cancellation of existing agreements in order to take service under the proposed tariff. Ex. SMEPA-10 at 28. Entergy eventually filed a network tariff, but proposed different local facilities charges for the various Entergy public utility operating subsidiaries. Id. at 29. Since these local facilities charges were higher than the transmission component of the subsidiaries' bundled rates, Entergy obtained a competitive advantage. Id.

4. The Arkansas Cities and Cooperatives (ACC) is a group of cities and cooperatives that own or operate electric generation or distribution systems in Arkansas. ACC Witness Steven Merchant testified that Entergy has segregated the wholesale market between two of its subsidiaries, Arkansas Power & Light Copmpany (APL) and Entergy Power, Inc. (EPI). Ex. SMM-1 at 16. In marketing power and energy in Arkansas, EPI is subject to an Arkansas Commission order that bars EPI from competing with APL for wholesale loads without first obtaining a waiver. Id. Recently, EPI requested this waiver for all wholesale transactions in Arkansas except for wholesale customers currently served by an Entergy subsidiary; in other words, EPI requested the Arkansas Commission to expand competition for all wholesale

customers except where EPI might compete with APL. Id. ACC witness Merchant concluded that, since EPI does not compete with APL, Entergy insulates APL's wholesale business from competition and denies those wholesale customers access to EPI as a source of power, thereby limiting alternative generation sources available to ACC. Id. at 17-19. (Entergy's witness Kenney stated that Entergy has recently filed a joint motion with ACC to the Arkansas Commission seeking to extend the waiver and permit EPI to sell to APL's wholesale customers. Ex. JFK-11 at 14-15.)

C. Pacific Gas & Electric Company (PG&E)

Northern California Power Agency (NCPA) attached several documents to its 1988 complaint in Docket No. EL89-4. These documents were provided to support NCPA's claim that PG&E's unreasonable practices under the PG&E/NCPA Interconnection Agreement (IA) effectively denied NCPA access to transmission properly requested under the IA. Although the parties eventually settled and the Commission terminated the docket with a letter order dated May 18, 1988, these documents provide allegations of PG&E using dilatory tactics that so protracted negotiations as to effectively equal a refusal to wheel.[3]

1. PG&E stated that since transmission was not currently available, it was entitled to wait 72 months before providing transmission; that is, transmission access could not be granted before the passing of the 72-month notice period. NCPA 1988 Complaint, Ex. 3. However, the IA provided that transmission be provided when it becomes actually

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[3] All of these incidents are related to and examples of PG&E's conduct described in the NOPR (*FERC Statutes and Regulations* ¶32,514, at p. 33,073 n.151), that is, the history of PG&E's attempt to avoid its commitments made to the California owners of the California Oregon Transmission Project (COTP). However, these incidents are not exactly the same as the incidents described in the NOPR, because NCPA is not one of the owners of the COTP.

available. PG&E also requested substantial additional information, which NCPA considered beyond that reasonably necessary for a study, but still provided. PG&E then determined that transmission was not available, reasoning that transmission was unavailable unless all the transmission requested could be provided 8760 hours per year without restrictions or limitations, extending through the expiration of the agreement in 2013. NCPA 1988 Complaint at 9.

2. On November 27, 1987, NCPA made a new transmission request to PG&E, seeking 50 MW of bi-directional transmission at Midway. NCPA 1988 Complaint, Ex. 5. On January 28, 1988, PG&E filed an interconnection agreement with Turlock Irrigation District (TID) that provided TID with 50 MW of bi-directional transmission at Midway. Pacific Gas & Electric Company, 42 FERC para. 61,406, order on reh'g, 43 FERC para. 61,403 (1988). On February 22, 1988, PG&E advised NCPA that all firm transmission service available at Midway had

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been fully subscribed. NCPA 1988 Complaint, Ex. 6. Then, on March 29, 1988, PG&E filed with the Commission an interconnection agreement with Modesto Irrigation District (MID), that provided MID with 50 MW of bi-directional transmission at Midway. Pacific Gas & Electric Company, 44 FERC para. 61,010 (1988). At about the same time (in the last week in March 1988), PG&E advised NCPA that the allocations of transmission to TID, MID, and others, including a not yet finalized allocation to Sacramento Municipality Utility District, had used all the transmission available at Midway. NCPA 1988 Complaint, Exs. 7 and 8.

D. Northeast Utilities Service Company (NU)

This is the case where Northeast Utilities acquired Public Service of New Hampshire (PSNH) (Docket No. EC90-10). New England Power Company (NEP) witness Robert Bigelow's direct testimony expressed concern over

the "relatively restrictive transmission policies of both" NU, on behalf of Northeast Utilities' public utility subsidiaries, and PSNH. Bigelow Direct Testimony at 21 (filed May 25, 1990). In his cross rebuttal testimony, Mr. Bigelow testified that "NU has a poor track record as a provider of transmission service" and "PSNH also has an abhorrent track record as a provider of transmission services." Bigelow Cross Rebuttal Testimony, at 3 (filed June 20, 1990). Mr. Bigelow described both NU's and NEP's (his own company) failure to provide service flexibility equivalent to their own use. Except for NEP's TDUs, both NEP and NU historically provided only point-to-point transmission, which required separate scheduling for each transaction. Bigelow Cross Rebuttal at 4.

E. Southern California Edison Company and San Diego Gas and Electric Company

The evidence in this merger proceeding (Docket No. EC89-5) included testimony from a number of witnesses describing instances of Edison's conduct. Richard Greenwalt was the power supply supervisor for the City of Riverside, California. He was responsible for scheduling all purchases of energy for Riverside and for the cities of Azusa, Banning and Colton, California. Greenwalt testimony at 1 (November 1989). (These four cities and Anaheim, California, are collectively referred to as the Southern Cities or Cities.) Joseph Hsu was the Director of Utilities for Azusa. Hsu testimony at 1 (November 1989). Gale Drews was the electric utility director of Colton. Drews testimony at 1-2 (November 1989). Bill Carnahan was the director for Riverside. Carnahan testimony at 1 (November 1989). Gordon Hoyt was the general manager of the Anaheim power department. Hoyt testimony at 1 (November 1989). Dan McCann was the power coordination supervisor for Anaheim. He supervised Anaheim's load scheduling and is a former Edison employee, having worked for Edison for 20 years. McCann Testimony at 1-2 (November 1989). These witnesses testified that Edison refused to wheel as follows.

1. Edison's policy was to curtail the Cities any time it could be justified using any of a list of acceptable reasons to deny interruptible transmission service. Id. at 22-23.

2. Edison would not generally provide transmission service when Edison could save money by itself purchasing the economy energy that would be wheeled. McCann testimony at 19. The Cities called Edison every hour to request interruptible transmission service. Id. Edison often refused to sell energy available in the Western Systems Power Pool to the Cities and then made available higher cost contract energy or partial requirements service. Id. at 19-20.

3. When Anaheim requested Edison provide firm transmission of power from neighboring states, Edison would often agree to provide non-firm service but would not integrate the capacity for many years in the future, saying that its control area did not need capacity at that time. Hoyt testimony at 9. Since the selling utility was interested in a sale of capacity, not just energy, the transaction would not occur. Id. Edison repeatedly used its control over transmission to deny Anaheim access to low-cost firm power. Id. at 9-10.

4. While Edison provided short-term firm transmission service to the Cities, it would only provide long-term firm service for three specific resources: The SONGS nuclear plant, a specific IPP, and Hoover Dam power. Hoyt testimony at 20. One of Edison's reasons for denying long-term transmission was that Edison desired to

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reserve the transmission for its own future (unspecified) needs. Id.

5. In the 1970s, Edison refused to allow the Cities access to the Pacific Intertie. Hoyt testimony at 21; Drews testimony at 7-8.

6. In 1988, Edison refused to provide transmission service for a Cities power purchase from Public Service Company of New Mexico (PSNM) from Palo Verde Nuclear station. Hoyt testimony at 21.

7. Edison has refused to provide requested firm transmission from

--California-Oregon border to Midway Station

--Nevada-Oregon Border to Sylmar Substation

--Palo Verde Switchyard to Vista

--SONGS Switchyard to Vista.

Carahan testimony at 15.

8. Riverside requested transmission from Palo Verde and was told that such service was not available. Carnahan testimony at 16. Edison offered Riverside only 12 MW of curtailable transmission entitlement to provide Riverside's share of Palo Verde. Id. This service was neither large enough or long enough, and Edison insisted on unreasonable terms and conditions. Id.

9. Azusa, Banning and Colton had a contract with Edison that entitled them to use their Palo Verde firm transmission path to schedule energy to meet their contract energy obligation. Edison refused to permit the three cities to use that path. Edison did not contest that the contracts allowed this use, but said that the scheduling of such small amounts of energy for the three cities would be too burdensome. Greenwalt testimony at 14.

10. Edison would not respond in a timely manner to the Cities' requests, routinely taking months to respond. Drews testimony at 15.

11. During the 1980s, Edison provided Colton with some transmission service to allow the Cities to reach certain suppliers, but limited the choices available to the Cities and imposed terms and conditions that increased the Cities' costs

and placed Colton at a disadvantage against Edison. Drews testimony at 9. Arranging alternative generation sources was difficult because the Cities always had to first get Edison to state whether it would provide transmission.

12. During 1988 and 1989, a dispute arose between Edison and the Cities concerning the Hoover Uprating Project. Drews testimony at 16. Edison argued that for the months when units were out of service for uprating, and Southern Cities capacity was reduced to zero, Southern Cities would not receive an energy credit, even though energy was still available and used by Edison. But the contracts allowed a participant who did not have capacity to still schedule its energy as non-firm energy on the capacity of another participant. Id. at 16-17.

13. In 1986, Azusa negotiated a power purchase contract with the California Department of Water Resources in increments of first 5 MW and then 2 MW (for a total of 7 MW). Hsu testimony at 14. First Edison assured Azusa that the transmission for the additional 2 MW would not be a problem. Id. Then Edison would not agree to amend the transmission service agreement for the additional 2 MW. Id.

14. In 1986, Azusa notified Edison of Special Condition 12[4] purchases from PG&E and requested firm transmission service. Id. Two months before service was to begin, Edison notified the Cities of a problem with the transmission lines. Id. Transmission was eventually granted, but only after a four-month delay and substantial losses to the Cities. Id. Then Edison decided there was no problem with its transmission facilities. Id. at 14-15.

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[4] Special Condition 12 of the Integrated Operations Agreement between Edison and the Southern Cities defined certain Special Condition 12 resources and allowed the Cities to make certain uses of those resources, subject to certain restrictions.

15. In 1986-87, the Cities purchased 20 MW from PG&E and 80 MW from Deseret G&T Cooperative. Hoyt testimony at 7-8. Edison stated that without reinforcement of its transmission system, Edison would not provide the transmission. Id. There was a five-month delay during which the Cities were forced to purchase from Edison at a higher cost. Id. at 8-9. Then Edison decided that the transmission system did not need reinforcement. Id. at 8.

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16. Edison also refused to provide a service priority equal to that of native load. It would curtail the Cities in order to purchase more economy energy for itself. McCann testimony at 28. If Edison could make the purchase, it would curtail the City and use the energy for itself. Id. When Edison curtailed the Cities, they were not able to purchase economy energy and instead purchased energy from Edison. Id. at 24.

17. According to Edison, the interruptible transmission it provided the Cities was interruptible for any reason. Id. at 20. A purchase could be terminated the hour after it is begun or even during the hour. Id. As a result, the Cities lost opportunities to make advantageous economy purchases. Id. at 20-21.

18. Edison also refused to provide customers flexibility similar to the flexibility Edison provided itself. Edison's refusal to provide bi-directional transmission service restricted the Cities' abilities to purchase hydroelectric energy from the Pacific Northwest. Hoyt testimony at 22. Because most contracts with Northwest utilities require a return of power, the Northwest utilities would not deal with the Cities without transmission to return energy. Id. at 22-23. Edison did provide bi-directional transmission to the Los Angeles Department of Water & Power (LADWP) to accommodate flows to and from Arizona. Id.

19. Riverside was unable to obtain non-firm service more than two hours in advance of need. Carnahan testimony at 18.

20. Riverside and Colton were both served out of Edison's Vista substation. Although the two cities were on the same 69 kV bus, Edison would not allow them to sell energy to each other. Greenwalt testimony at 17.

21. Riverside's agreement with Edison allowed Riverside to purchase a block of energy through the WSPP and divide it up among the four Cities (Azusa, Banning, Colton and Riverside). Greenwalt testimony at 17. When Riverside had excess energy from other sources, Edison would not permit it to sell that energy to the other three cities. Id. For example, Riverside attempted to sell Deseret energy transmitted by LADWP to the Edison system. Id. at 17-18. LADWP would not break out the Cities' shares of that energy, and Edison would not accept the energy as a delivery for all four cities. Id. at 18. Edison argued that because this energy was excess energy that Riverside could not use, Riverside did not have transmission rights to bring it into the control area. Id. As a result, Riverside paid for the energy delivered by LADWP to the Edison control area, but could not sell it to the other three cities, and gave it to Edison itself, which consumed the energy without making any payment for it. Id. Riverside tried a number of alternative paths, including using WSPP transmission where Riverside paid Edison 5 mills to connect to Azusa, 5 mills to connect to Banning, and 5 mills to connect to Colton for each megawatthour. While this approach was successful for a while, eventually Edison refused to permit these sales.

22. Edison claimed that the Cities only have transmission rights to bring in enough Special Condition 12 energy to satisfy the Cities' load. Greenwalt testimony at 18.

23. Edison contended that the Cities' load requirements were satisfied first by integrated resources and then by

Special Condition 12 and economy energy purchases. Id. at 19. When the Cities' integrated resources exceeded their load, any Special Condition 12 resources became excess. Under Riverside's Deseret contract, the Cities were required to take a minimum of 35 MW each hour. Id. Edison acknowledged that it was obligated to buy, or allow the Cities to sell, any excess energy from Riverside's integrated resources. Id. However, Edisor refused to give the Cities credit for excess Special Condition 12 energy brought into the area, claiming that the Cities could not have brought it in because they did not have transmission rights. Id.

II. Other Examples of Transmission Disputes

Disputes over transmission are not uncommon, contrary to EEI's suggestion. Some recent examples taken from pleadings and other documents and from Commission orders reveal that it has been very difficult for various entities in the electric power industry to agree on transmission rights. These examples also reveal that even after issuance of AEP and the Open Access NOPR with its proposed pro forma tariffs, there has been considerable controversy over whether various utilities'

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"open access" tariffs deviate from those tariffs. (The Commission has allowed utilities that adopt tariffs that match or exceed the non-rate terms and conditions in the NOPR pro forma tariffs to obtain certain benefits.)

A. In a letter of February 3, 1995 to Mr. Gerald Richman of the Commission's Enforcement section in the Office of the General Counsel, Steven J. Kean, Vice President, Regulatory Affairs, Enron Power Marketing, Inc. (Enron) alleged that Niagara Mohawk Power Corporation (NiMo) refused to wheel power from Rochester Gas & Electric (RG&E) to Enron under RG&E's transmission contract with NiMo; however, when Enron revealed the buyer, NiMo did wheel power for RG&E to the buyer. Mr. Kean alleged that this was

not an isolated incident. NiMo argued that the contract did not require it to provide RG&E with transmission to Enron. It also said that the principle of comparability does not require the service. Letter of November 21, 1994 from NiMo representative A. Karen Hill to Gerald Richman.

B. The Commission's Task Force Hot Line (Hot Line) received a complaint that a member of the New York Power Pool (NYPP) refused to transmit power that another member bought from a power marketer. In a letter of November 17, 1994, from Chair Moler to Mr. William J. Balet, Executive Director of NYPP, Chair Moler explained that the Commission's enforcement staff had investigated and found the allegation to be true.

C. In Southern Minnesota Municipal Power Agency v. Northern States Power Company (Minnesota), 73 FERC para. 61,350 (1995), NSP and SMMPA had a contract under which NSP agreed to provide transmission service. However, the parties had numerous disputes over the service. The Commission found that NSP had misinterpreted the contract in several ways. For, example, SMMPA argued that it should be able to directly schedule its deliveries of energy out of the NSP control area and that it should not be limited to particular points of delivery. NSP argued that only it was entitled to control the physical operation of scheduling. The Commission found that the clear language of the contracts gave SMMPA the authority to schedule its owr power.

D. Mid-Continent Area Power Pool, 72 FERC para. 61,223 (1995), involved MAPP's membership criteria, which made it impossible for a power marketer to join MAPP and obtain the benefits of certain transmission services available only to MAPP members. The Commission found that the membership criteria may be unreasonable, particularly since there may be less burdensome ways of setting up membership criteria for non-traditional entities.

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Appendix G

I. Legal Analysis of Commission Jurisdiction Over the Rates, Terms and Conditions of Unbundled Retail Transmission in Interstate Commerce

Based on an analysis of the relevant legislative history and case law under the Federal Power Act (FPA), the Commission concludes that it has exclusive jurisdiction over the rates, terms and conditions of the unbundled transmission in interstate commerce, by a public utility, of electric energy to an end user. This is also known as retail wheeling in interstate commerce.[1]

The Commission's jurisdiction over the rates, terms and conditions of transmission in interstate commerce derives from Congress' power to regulate interstate commerce under the United States Constitution[2] and the FPA. When Congress enacted the FPA, it gave the Commission exclusive jurisdiction over the rates, terms and conditions of transmission in interstate commerce by public utilities. The Supremacy Clause of the Constitution provides that federal laws enacted pursuant to the powers delegated to the federal government by the United States Constitution are the supreme law of the land.[3] Accordingly, to the extent that retail wheeling involves transmission in interstate commerce

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1 Section 212(h) of the FPA provides that no order issued under the FPA shall be conditioned upon or require the transmission of electric energy directly to an ultimate consumer. 16 U.S.C. §824k(h). The Commission's assertion of jurisdiction in this final rule is over the rates, terms and conditions of retail transmission that occurs voluntarily or as a result of a state retail access program.

2 U.S. Const. art I, Section 8, cl.3.

3 U.S. Const. art. VI, cl.2.

by public utilities, the rates, terms and conditions of such service are subject to the exclusive jurisdiction of the Commission, and must be filed with the Commission.[4]

1. Relevant Federal Power Act Provisions

Section 201(b)(1) of the FPA provides:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

16 U.S.C. 824(b)(1) (emphasis added). Thus, the statute on its face limits Commission jurisdiction over sales of energy to sales at wholesale, but does not limit jurisdiction

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over transmission to transmission used only for wholesale sales.

Sections 201(c) and (d) define the meaning of "the transmission of electric energy in interstate commerce" and "sale of electric energy at wholesale in interstate commerce." Section 201(c) provides:

For the purpose of this Part, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

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[4] *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951) (*Montana-Dakota*).

16 U.S.C. 824(c). Section 201(d) provides:

The term "sale of electric energy at wholesale" when used in this Part means a sale of electric energy to any person for resale.

16 U.S.C. 824(d).

Sections 205 and 206 of the FPA give the Commission jurisdiction over the rates, terms and conditions of transmission in interstate commerce, and sales at wholesale in interstate commerce, by public utilities. 16 U.S.C. 824d and 824e.

2. Legislative History and Case Law

Much of the legislative history of the FPA indicates that Congress intended the Commission's jurisdiction to extend only to those matters which the Attleboro decision[5] held to be beyond the reach of the States. For instance, the report accompanying the Senate bill states that subsection (b) "leaves to the States the authority to fix local rates even in cases where the energy is brought in from another State."[6] In other words, states retain authority to regulate rates of electric energy to ultimate consumers. The Senate report also states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by

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5 *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) (Attleboro). In Attleboro, the Supreme Court held that State regulation of the interstate sale of electricity was barred by the Commerce Clause because such regulation would impose a "direct burden" on interstate commerce.

6 S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). See also H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935).

those lines and over the generating facilities which produce energy[7] for interstate transmission and sale.

S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935) (emphasis added). Thus, federal jurisdiction over transmission lines is not dependent on whether those lines are used to effect a sale, wholesale or otherwise.

The provisions of FPA section 201 reserving certain regulatory authority to the States have been interpreted narrowly.[8] The Supreme Court has stated:

In section 201(b), Congress did no more than leave standing whatever valid state laws then existed relating to the exportation of hydroelectric energy; by its plain terms, section 201(b) simply saves from pre-emption under Part II of the Federal Power Act such state authority as was otherwise "lawful."[9]

The Court also stated:

Nothing in the legislative history or language of the statute evinces a congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause,' *

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7 The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

8 Section 201(a) declares that Federal regulation of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, "such Federal regulation, howe.er, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. §824(a). Section 201(b)(1) states that the provisions of Part II of the FPA apply to the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce but, except as specifically provided, "shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line." 16 U.S.C. §824(b)(1).

9 *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (NEPCO).

* * or to modify the earlier holding of this Court concerning the limits of state authority to restrain interstate trade.[10]

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Unlike the narrow interpretations given to the FPA provisions reserving certain regulatory authority to the States,[11] the courts have construed transmission "in interstate commerce" broadly. The term does not turn on whether the contract path for a particular power or transmission sale crosses state lines, but rather follows the physical flow of electricity. Because of the highly integrated nature of the electric system, this results in most transmission of electric energy being "in interstate commerce."

One of the earliest cases construing Commission jurisdiction over transmission was Jersey Central Power & Light Co. v. FPC, 319 U.S. 61 (1943) (Jersey Central). In that case, the Commission asserted jurisdiction over a New Jersey utility by showing that the utility owned transmission facilities that were used to transmit energy in interstate commerce. The Court found that the Commission had demonstrated that the utility owned transmission facilities that were indirectly interconnected, through a second New Jersey utility, to facilities owned by a New York utility and that the facilities were used to transmit electric energy in interstate commerce.

The Court noted that section 201(c) of the FPA defines electric energy transmitted in interstate commerce to be

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10 *Id.* (citation omitted).

11 While Congress may exercise its Commerce Clause authority to grant the States that "ability to restrict the flow of interstate commerce that they would not otherwise enjoy," Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 44 (1980), States may not exercise such regulatory powers unless Congress has expressly stated its intention to make such an affirmative grant of power. *NEPCO*, 455 U.S. at p. 343.

energy "transmitted from a State and consumed at any point outside thereof." The Court stated:

> It is impossible for us to conclude that this definition [of transmission in interstate commerce] means less than it says and applies only to the energy at the instant it crosses the state line and so only to the facilities which cross the line and only to the company which owns the facilities that cross the line.

319 U.S. at 71. Thus, a critical question regarding the jurisdictional status of a wheeling transaction is whether the facilities used to provide the service transmit electric energy in interstate commerce.

In Connecticut Light & Power Co. v. FPC, 324 U.S. 515 (1945) (CL&P), the Court reviewed the Commission's finding that a Connecticut utility was jurisdictional because it owned transmission facilities that were used in interstate commerce. The Court generally embraced the Jersey Central standard for determining whether facilities are used to transmit electric energy in interstate commerce. The Court emphasized that whether certain facilities transmit electric energy in interstate commerce is more a technical than a legal question. The Court stated:

> Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test.

324 U.S. at 529. Thus, the Court adopted the Jersey Central test providing that the Commission's jurisdiction generally extends to transmission facilities that transmit electric energy in interstate commerce.

The Court also applied the Jersey Central test in FPC v. Florida Power & Light Co., 404 U.S. 453 (1972), affirming the Commission's finding of jurisdiction over a Florida utility. The Commission demonstrated that the utility

transmitted power to another Florida utility's "bus"[12] and that power was simultaneously transferred from the "bus" to a Georgia utility. The Court upheld the Commission's finding that electric energy from the two Florida utilities was commingled and was therefore transmitted in interstate commerce. 404 U.S. at 463.

In all of the above cases, the Court's decisions turned on whether energy being transmitted flowed in interstate commerce as a technical matter. The decisions did not turn on whether the transmission of energy flowing in interstate commerce involved energy that was being sold for resale or was being sold to

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an end user. Thus, there is nothing in the statute, its legislative history, or the case law to indicate that the Commission's jurisdiction over rates, terms and conditions of transmission in interstate commerce extends only to wholesale transmission and not retail transmission. Indeed, the statute on its face gives the Commission jurisdiction over transmission in interstate commerce and makes no distinction between wholesale transmission and retail transmission.

However, there are two important limitations on Commission authority. First, as discussed above, the FPA does not give the Commission jurisdiction over sales of electric energy at retail. Such sales historically have been bundled sales (i.e., generation and transmission), and courts and the Commission have recognized State jurisdiction over bundled sales of energy. Second, under section 201(b)(1) of the FPA, the Commission does not have jurisdiction over facilities used in local distribution. In CL&P, the Court stated

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[12] A bus is an electrical conductor which serves as a common connection for two or more electrical circuits. Electric Utility Rate Design Study, Glossary: Electric Utility and Ratemaking Load & Management Terms, Edison Electric Institute (Sept. 11, 1978).

that local distribution facilities are exempt from Commission jurisdiction even if those facilities "carry no energy except extra-state energy." 324 U.S. at 531.

In the next section the Commission further discusses the statutory provisions and case law that shed light on the demarcation between transmission and local distribution, and thus on the jurisdictional line between federal and State authority.

II. Legal Analysis of Commission Jurisdictional Transmission Facilities and State Jurisdictional Local Distribution Facilities

Two specific circumstances are addressed:

First, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

Second, what facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to an end user?

Based on an analysis of the relevant legislative history and case law under the FPA, the Commission reaches the following conclusions. With respect to the first circumstance, the Commission concludes that a public utility's facilities used to deliver electric energy to a wholesale purchaser, whether labeled "transmission," "distribution," or "local distribution" are subject to the Commission's exclusive jurisdiction under sections 205 and 206 of the FPA, and that a public utility's facilities used to deliver electric energy from the wholesale purchaser to the ultimate consumer are

"local distribution" facilities subject to the rate jurisdiction of the state.[13]

With respect to the second circumstance, the Commission believes that, based on the particular facts of the case, some of the public utility's facilities used to deliver electric energy to an end-user may be FERC-jurisdictional transmission facilities, while some of the facilities used may be state-jurisdictional local distribution facilities.

We set forth below the relevant legislative history and case law, our legal conclusions, and the factors which we believe are indicative of whether facilities are used in "local distribution" or "transmission in interstate commerce," as those terms are used in the FPA.

1. Relevant Federal Power Act Provisions

The Commission's jurisdiction is set forth in section 201 of the FPA.[14] Section 201(b)(1) provides in pertinent part:

The provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * *. The Commission shall have jurisdiction over all facilities for

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such transmission or sale of electric energy, but shall not have jurisdiction * * * over facilities used in local distribution or only for the transmission of electric energy in

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[13] There are, of course, facilities that are used to provide delivery to both wholesale purchasers and end users. In those situations, we believe that the Commission and the States have jurisdiction to set rates for the services that are within their respective jurisdictions. That facilities are used to serve resale and retail customers does not, however, necessarily mean that the facilities are local distribution facilities.

[14] 16 U.S.C. §824.

intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.[15]

Some of the court decisions that construe jurisdictional facilities under section 201 also construe the Commission's jurisdiction under section 203. Section 203(a) provides, in relevant part:

No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, * * * or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person * * * without first having secured an order of the Commission to do so.[16]

In addition, section 206(d) concerns facilities "under the jurisdiction of the Commission":

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.[17]

2. Legislative History of the FPA

The relevant legislative history of the general purposes of Title II of the FPA, and of section 201 in particular, focuses primarily on bundled sales of electric energy and does not directly address the issue of what constitutes local distribution as opposed to transmission in interstate commerce.

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15 16 U.S.C. §824(b) (emphasis added).

16 16 U.S.C. §824b (emphasis added).

17 16 U.S.C. §824e(d) (emphasis added).

In discussing the general purposes of Title II of the House bill, the House Report states:

Title II * * * establishes for the first time regulation of electric utility companies transmitting energy in interstate commerce.

* * * * *

* * * Under the decision of the Supreme Court of the United States in (Attleboro), the rates charged in interstate wholesale transactions may not be regulated by the States. Part II gives the Federal Power Commission jurisdiction to regulate these rates. A "wholesale" transaction is defined to mean the sale of electric energy for resale and the Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce.[18]

In its analysis of section 201, the House Report states:

As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State.[19]

The Senate Report's discussion of the general purposes of the FPA states:

The decision of the Supreme Court in (Attleboro) placed the interstate wholesale transactions of the electric utilities entirely beyond the reach of the States. Other features of this interstate utility business are equally immune from State control either legally or practically.[20]

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[18] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7-8 (1935).

[19] *Id.* at p. 27.

[20] S. Rep. No. 621, 74th Cong., 1st Sess. at p. 17 (1935). See *id.* at p. 18 ("The revision [between the original and final versions of the Senate bill] has also removed every encroachment upon the authority of the

In discussing material differences between the final version of the Senate bill and the original version, the Senate Report states:

Subsection (b), formerly (a), which states the subject matter to which the part relates, has been clarified to make plain that it includes interstate transmission where there is no sale and excludes

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all facilities used only for production of transmission in intrastate commerce or in local distribution.[21]

In discussing section 201 of the Senate bill, the Senate Report further states:

The rate-making powers of the Commission are confined to those wholesale transactions which the Supreme Court held in (Attleboro) to be beyond the reach of the States. Jurisdiction is asserted also over all interstate transmission lines whether or not there is sale of the energy carried by those lines and over the generating facilities which produce energy for interstate transmission and sale. It is obvious that no steps can be taken to secure the planned coordination of this industry on a regional scale unless all of the facilities, other than those used solely for retail distribution, are made subject to the jurisdiction of the Commission. Facilities used only for intrastate commerce or local distribution are expressly excluded from the operation of the act.[22]

States. The revised bill would impose Federal regulation only over those matters which cannot effectively be controlled by the States.")

21 *Id.* at p. 19.

22 *Id.* at p. 48. The provisions of the Senate bill regarding federal jurisdiction over generating facilities were eliminated from the final version of the bill.

The Conference Report adds little description regarding jurisdictional facilities. In reference to section 201(b) it states that:

[T]he language of the House amendment has been followed with a clarifying phrase added to remove any doubt as to the Commission's jurisdiction over facilities used for the generation and local distribution of electric energy to the extent provided in other sections of this part and the part next following.[23]

In addition to the above statements pertaining to section 201 of the FPA, Congress referenced distribution of energy in the legislative history of section 206(d). Section 206(d) was originally enacted as section 206(b) of the FPA. Under the Regulatory Fairness Act of 1988,[24] section 206(b) was redesignated as section 206(d).

The Conference Report on the original FPA does not address section 206(b). The Senate Report on the FPA bill states in pertinent part:

Subsection (b) authorizes the Commission to investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy. * * * Since the rate-making powers granted to the Commission apply only to the wholesale rates of energy sold in interstate commerce, this last subsection should be of great benefit in removing the practical difficulty which the States may encounter in regulating the interstate distribution rates which are left under their control. Such rate regulation involves the examination and valuation of property outside the State. The task is one requiring an agency with a

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23 H.R. Conf. Rep. No. 1903, 74th Cong., 1st Sess. 74 (1935).

24 Pub. L. No. 100-473, 102 Stat. 2299 (1988).

jurisdiction broader than that of a single State. The authority of the Federal Commission is to render assistance to the State commissions in a way which would preserve and make more effective the jurisdiction which is thus left to the States.[25]

The House Report discusses section 206(b) as follows:

This subsection reaches those situations where electric energy is transmitted in interstate commerce by the same company which distributes it locally, and will greatly aid State commissions in fixing reasonable rates in such cases.[26]

Thus, the discussions in the two reports do not appear to contemplate a situation in which the transmitter and seller of electric energy are different, and neither is a "local" distributor. The House Report expressly refers to the same company being the transmitter and seller of electric energy. The Senate Report by its terms addresses the regulation of interstate distribution rates.[27]

The above legislative history on sections 201 and 206(b) does not provide any

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definitive answers to the questions raised. We therefore turn to the case law under the FPA.

3. Case Law Under the FPA

Jersey Central was the first of the major FPC jurisdictional cases considered by the Supreme Court. The

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[25] S. Rep. No. 621, 74th Cong., 1st Sess. 51 (1935) (emphasis added).

[26] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 29 (1935) (emphasis added).

[27] The Senate Report states that interstate distribution rates are left in the States' control. Obviously, the Senate drew a distinction between interstate distribution (left in the States' control) and interstate transmission (given to the FPC). Compare S. Rep. No. 621 at p. 49 with H.R. Rep. No. 1318 at p. 51.

case involved the acquisition by New Jersey Power and Light Company (New Jersey Power) of certain securities of Jersey Central Power & Light Company (Jersey Central) without the Commission's prior approval. The question before the Court was whether Jersey Central was a "public utility" under section 201(e)[28] of the FPA so that the Commission's prior approval of the stock acquisition was necessary under section 203 of the FPA.

Jersey Central owned transmission facilities that connected to facilities that Public Service Electric & Gas Company (Public Service) owned. The interconnection of these transmission facilities was in New Jersey. Public Service's facilities in turn connected to the facilities of the Staten Island Edison Corporation (Staten Island Edison), a New York utility, at the mid-channel of Kill van Kull, a body of water separating New Jersey and New York. Jersey Central delivered energy to and received energy from Public Service under contract, and Public Service delivered energy to and received energy from Staten Island Edison under contract.[29]

The Court found that, although Jersey Central generated and received electricity only in New Jersey, some of the electric energy that it dispatched to Public Service "was instantaneously transmitted to New York."[30] The Court held that "[t]his evidence * * * furnishes substantial basis for the conclusion of the Commission that facilities of Jersey Central are utilized for the transmission of electric energy across

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28 Section 201(e) defines a "public utility" as "any person who owns or operates facilities subject to the jurisdiction under this Part (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)." 16 U.S.C. §824(e). The section as adopted in 1935 did not contain the parenthetical, which was adopted in 1978 as part of the Public Utility Regulatory Policies Act.

29 Jersey Central, 319 U.S. at pp. 63-65.

30 *Id.* at p. 66.

state lines."[31] Therefore, the Court found that Jersey Central was a public utility within the meaning of section 201(e).[32]

The Court cited Attleboro, in which the Court found that the sale of locally produced electric energy for use in another state resulted in the transmission of electric energy in interstate commerce, even though title passed at the state line.[33] In Jersey Central, the Court explained the rationale for federal jurisdiction as follows:

(Section 201(c) of the FPA) defines the electric energy in commerce as that "transmitted from a State and consumed at any point outside thereof." There was no change in this definition in the various drafts of the bill. The definition was used to "lend precision to the scope of the bill." It is impossible for us to conclude that this definition means less than it says * * *. The purpose of this act was primarily to regulate the rates and charges of the interstate energy.[34]

The Court in Jersey Central thus interpreted the FPA as placing within the federal province regulation of wholesale sales of electric energy that, in any manner, flows in interstate commerce. The language quoted above and the citation to section 201(c) of the FPA, to be relied upon in subsequent Supreme Court cases, strongly suggested that the Commission's jurisdiction was not based on whether there was a sale by the utility, but rather on the flow of electric energy either into or out of a state, so long as the energy crosses state lines.

CL&P, which was decided two years after Jersey Central, is the leading case interpreting the section 201(b) local distribution proviso. In CL&P, the Commission sought

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31 *Id.* at p. 67 (citation omitted).

32 *Id.* at p. 73.

33 273 U.S. at pp. 86, 89-90.

34 319 U.S. at p. 71 (footnote omitted).

to regulate the accounting practices of Connecticut Light & Power Company (CL&P).[35] At issue was whether

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CL&P was a "public utility" under the FPA. The utility's system encompassed an area solely within a single state (Connecticut)[36] and did not interconnect with any other company that operated out of state.[37] "Its purchases and sales, its receipts and deliveries of power, (were) all within the state."[38] However, CL&P did purchase energy from companies that had, in turn, purchased energy from Massachusetts. The company also sold energy to a municipality that exported a portion of that energy to Fishers Island, located off the coast of Connecticut but "territory of New York."[39] The Commission based its jurisdiction on these few transactions.[40]

The Court of Appeals affirmed the Commission, holding that the Commission's jurisdiction extended to "electric distribution systems which normally would operate as interstate businesses." The Court of Appeals found that:

Whether or not the facilities by which petitioner distributes energy from Massachusetts should be classified as 'local' is not relevant to this case. The sole test of jurisdiction of the Commission over accounts is whether these facilities,

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35 CL&P, 324 U.S. at p. 517.

36 *Id.* at p. 518.

37 *Id.* at p. 521.

38 *Id.* at p. 522.

39 *Id.* at pp. 519-21.

40 *Id.*

'local' or otherwise, are used for the transmission of electric energy from a point in one state to a point in another.([41])

The Supreme Court reversed. It held that the statutory language in section 201(b) of the FPA providing that the Commission "shall not have jurisdiction * * * over facilities used in local distribution" is a limitation upon Commission jurisdiction that "the Commission must observe and the courts must enforce."[42] In analyzing the statute, the Court stated:

It has never been questioned that technologically generation, transmission, distribution and consumption are so fused and interdependent that the whole enterprise is within the reach of the commerce power of Congress, either on the basis that it is, or that it affects, interstate commerce, if at any point it crosses a state line.

* * * *

But whatever reason or combination of reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction * * * over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the claims of federal and local authorities and to apportion federal and state jurisdiction over the industry.[43]

The Court decided that this limitation on jurisdiction was "a legal standard that must be given effect in this case in addition to the technological transmission test."[44]

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41 *Id.* at p. 522, *quoting Connecticut Light & Power Co. v. FPC*, 141 F.2d 14, 18 (D.C. Cir. 1944).

42 324 U.S. at p. 529.

43 *Id.* at pp. 529-31.

44 *Id.* at p. 531.

The Court stated that whether or not local distribution facilities carried out-of-state electric energy was irrelevant. Whatever the origin of the electric energy they carried, so long as the utility used the lines for local distribution,[45] they were exempt from federal jurisdiction.[46] In fact, the Court stated that local distribution facilities "may carry no energy except extra-state energy and still be exempt under the Act." Id. at 531. The Court concluded that the Commission's order:

Must stand or fall on whether this company owned facilities that were used in transmission of interstate power and which were not facilities used in local distribution.[47]

Upon reversing the Court of Appeals, the Court commented, in dictum, on the evidence the Commission had relied upon in finding that the facilities in question were used for transmission. It noted that the Commission had relied upon certain gas transportation cases in concluding that transmission extends from the generator to the point where the function of conveyance in bulk over distance is completed

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and the process of subdividing the energy to serve ultimate consumers, which is the characteristic of "local distribution," is begun. The Court cautioned:

But a holding that distributing gas at low pressure to consumers is a local business is not a holding that the process of reducing it from high to low pressure is not also part of such local business. In so far as the Commission found in these cases a rule of law which excluded from the business of local distribution the process of reducing energy from high to

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[45] It appears that while the Company received power (at one location) at 66 kV, it primarily owned facilities at 13.8 kV and below.

[46] 324 U.S. at p. 531.

[47] *Id.* at p. 531 (emphasis added).

low voltage in subdividing it to serve ultimate consumers, the Commission has misread the decisions of this Court. No such rule of law has been laid down.[48]

The Court also noted in its dictum, however, that once a company is properly found to be a "public utility" under the Act, the fact that a local commission may also have jurisdiction does not preclude exercise of the Commission's functions. Id. at 533.[49] The Court instructed the lower court to remand the case to the Commission for a finding regarding whether the facilities in question were used in local distribution.[50]

The CL&P case was ultimately disposed of without the Commission having made a finding that the facilities were used in local distribution. While the Commission found that it was "extremely doubtful" that it could find that the facilities in question were not local distribution facilities, 6 FPC 104, 106 (1947), the Commission did not articulate a definition of local distribution facilities.

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48 *Id.* at p. 534.

49 *See United States v. Public Utilities Commission of California*, 345 U.S. 295, 316 (1953) (Public Utilities Commission): Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route "commingled" with other power sold by the same seller and eventually directly consumed by the same purchaser-distributor.

See also Arkansas Power & Light Co. v. FPC, 368 F.2d 376, 383 (8th Cir. 1966) ("Where a company is in fact a public utility, all wholesale sales for resale in interstate commerce are subject to the provisions of sections 205 and 206 of the (FPA), regardless of the facilities used."). The Eighth Circuit further noted that the section 201(b) exemption applies to a company's status as a public utility and not to the Commission's jurisdiction over sales in interstate commerce for resale. *Id., citing Public Utilities Commission, Colton, infra* and *Wisconsin-Michigan, infra.*

50 *Id.* at p. 536.

In Wisconsin-Michigan Power Co. v. Federal Power Commission,[51] the Seventh Circuit held that a utility was a jurisdictional public utility where it operated two divisions in Wisconsin and Michigan in a coordinated manner such that electric energy from one state was transmitted to the other, and vice versa, "in appreciable amounts by the power company and by it commingled with energy generated in the two respective districts and then delivered to the [wholesale] customers * * *."[52] The court also rejected the notion that the energy changed its form or character when it was stepped down in voltage before it reached the wholesale purchasers.[53]

The court in Wisconsin-Michigan distinguished between transmission and local distribution by focusing on wholesale sales of electric energy versus retail sales ("local rates") of electric energy. It cited the House Report on the FPA, and characterized the legislative history as follows:

The legislative history, (H.R. Rep. No. 1318), 74th Cong., 1st Sess. pages 7, 8 and 27 (1935), discloses that the Congressional Committee intended that the provisions of the (FPA) should apply to the transmission of electric energy in interstate commerce, i.e., the sale of energy at wholesale in interstate commerce, but not to the retail sale of any such energy in local distribution; that the (FPA) left to the state the authority to fix local rates where the energy is brought in from other states, and that the rate making power of the (FPC) was to be confined to those wholesale transmissions which the Supreme Court had held in (Attleboro) to be

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51 197 F.2d 472 (7th Cir. 1952), cert. denied, 345 U.S. 934 (1953) (*Wisconsin-Michigan*).

52 *Id.* at p. 474.

53 *Id.* ("Obviously the energy thus transmitted in interstate commerce is not changed in form or in character except that the voltage is reduced to an extent consistent with efficient economic management and operation.").

beyond the reach of the state. Under that decision, said the committee, the rates

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charged in interstate wholesale transactions could not be regulated by the states. It defined a wholesale transaction as the sale of electric energy for resale.[54]

The Seventh Circuit's characterization of the House Report seems to equate transmission of electric energy in interstate commerce with the sale of energy at wholesale in interstate commerce. However, this interpretation is at odds with both the plain words of the statute as well as the language of the House Report, both of which refer to transmission in interstate commerce separately from sales for resale in interstate commerce.[55] In addition, the Senate Report, which the Seventh Circuit did not mention, clearly recognized jurisdiction over all interstate transmission lines, whether or not a sale of energy is carried by those lines.[56]

The Wisconsin-Michigan court also cited analogous natural gas cases, stating that "[t]he question is essentially, when does interstate commerce transportation end and where do the local distribution facilities first become operative."[57] The court further stated that:

(U)pon delivery to (the wholesaler) local distribution begins when he resells. His sales and distribution at retail are

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54 197 F.2d at p. 476 (emphasis added).

55 See H.R. Rep. No. 1318 at p. 27. ("Subsection (b) confers jurisdiction upon the Commission over the transmission of electric energy in interstate commerce and the sale of electric energy in wholesale in interstate commerce * * *." emphasis added).

56 See S. Rep. No. 621 at p. 48 ("Jurisdiction is asserted over all interstate transmission lines whether or not there is a sale of the energy carried by those lines * * *.").

57 197 F.2d at p. 477.

clearly local in character, and constitute only local distribution; but at no point before delivery to him has been completed, has interstate transmission terminated. In other words, "facilities used in local distribution" means facilities used for making resale and distribution to consumers, jurisdiction over which is left to the states. It was only because of this conclusion that the Supreme Court said, (citation omitted), the Act "cut(s) sharply and cleanly between sales for resale and direct sales for consumptive uses." We think there is no ground for the position that local distribution includes any transmission occurring before the wholesaler who resells at retail is reached.[58]

The Seventh Circuit concluded that the sales for resale were made in interstate commerce; that local distribution had not begun; that the interstate character of the transmission persisted until delivery to the wholesaler; that, up to that point, no local distribution facilities were in operation and that, therefore, the sales were subject to Commission regulation.

In Federal Power Commission v. Southern California Edison Company (the Colton case),[59] the Supreme Court held that the FPA provides a clear line of demarcation between jurisdictional transactions and non-jurisdictional transactions. However, this case, too, involved bundled sales of electric energy. In the facts of the case, Southern California Edison Company (Edison) admitted that it was a public utility by virtue of owning two interstate transmission lines.[60] At issue was whether its sales of electric energy to the City of Colton,

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58 *Id., citing FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950) (East Ohio).

59 376 U.S. 205 (1964) (Colton).

60 The Supreme Court noted that Edison's status as a public utility did not decide the question of whether the FPC could assert jurisdiction over the rates for the Edison-Colton sale. Id. at p. 208 n.3.

California, for resale to Colton's retail customers, were jurisdictional. Included in the electric energy that Edison sold to Colton was out-of-state electric energy from Hoover Dam.[61] The Commission ruled that the sale to Colton was a sale of electric energy at wholesale in interstate commerce subject to regulation under the FPA.[62] In upholding the Commission, the Court held that Edison's importation of out-of-state electricity for resale to Colton sufficed to confer federal jurisdiction.

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The Court, citing an earlier Supreme Court case,[63] characterized Congressional intent in the FPA:

(W)hat Congress did was to adopt the test developed in the Attleboro line which denied state power to regulate a sale "at wholesale to local distributing companies" and allowed state regulation of a sale at "local retail rates to ultimate consumers."[64]

The Court rejected the argument that FPC jurisdiction was confined to those interstate wholesale sales constitutionally beyond the power of state regulation by force of the Commerce Clause, and was to be determined on a case-by-case analysis of the impact of state regulation upon the national interest. The Court stated that in the FPA:

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61 *Id.* at p. 208, 209 & n.5.

62 *Id.* at p. 208. *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 380 (1983) ("(Colton) held, among other things, that * * * a California utility that received some of its power from out-of-state was subject to federal and not state regulation in its sales of electricity to a California municipality that resold the bulk of the power to others.").

63 *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 504 (1942).

64 376 U.S. at p. 214.

(C)ongress meant to draw a bright-line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extend[ed] it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.[65]

The Court held that "(t)here is no such exception covering the Edison-Colton sale."[66]

Parties in the Colton case had raised the question of whether jurisdiction over the Colton sale was prevented by the "local distribution" proviso of section 201(b). The Court stated that whether facilities are local distribution facilities is a matter for the Commission to decide in the first instance. Citing CL&P, supra, it stated:

Whether facilities are used in local distribution—although a limitation on FPC jurisdiction and a legal standard that must be given effect in addition to the technological transmission test * * *—involves a question of fact to be decided by the FPC as an original matter.[67]

The Court cited evidentiary support and the Commission's expertise in such matters in upholding the Commission's determination that certain facilities owned by Edison were used exclusively to effect the wholesale sale to Colton and not for local distribution. Such facilities included 12 kV lines that served an industrial customer, several lighted highway signs, a residence and a railroad section house before they reached the transformers in the Colton substation. The FPC had held that those uses prior to the lines reaching

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65 *Id.* at pp. 215-216.

66 *Id.* at p. 216 (footnote omitted).

67 *Id.* at p. 210 n.6 (citation omitted).

the Colton substation did not transform the lines into local distribution facilities.[68]

In Duke Power Company v. Federal Power Commission (Duke),[69] the D.C. Circuit held that a public utility's acquisition of facilities used solely in local distribution, and which would continue to be used for local distribution, was beyond the Commission's jurisdiction under section 203. The case involved Duke Power Company's (Duke's) proposed acquisition of facilities owned by Clemson University (Clemson), which were used to distribute electricity off-campus to customers (primarily university personnel) in two South Carolina counties. Clemson purchased the power at wholesale from Duke. No one appeared to contest the conclusion that the 7 miles of distribution line and 418 service connections owned by Clemson were "local distribution" facilities.[70] Rather, the case turned on interpreting section 203 and whether it was intended to affect only acquisitions of jurisdictional facilities, or also to affect acquisitions of non-jurisdictional facilities. In interpreting section 203, however, the D.C. Circuit extensively analyzed and discussed the fundamental jurisdictional lines that Congress drew in section 201.

Citing to the CL&P case, the court in Duke stated:

The Act, as we have seen, effectuated federal control over the transmission and the sale at wholesale of electric energy in

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68 *Id.* at p. 210 n.6.

69 401 F.2d 930 (D.C. Cir. 1968) (Duke).

70 Duke delivered power to Clemson at a distribution voltage of 4,160 volts. The step-down transformers by which the voltage was reduced, and the substations at which the delivery was effected, were owned by Duke. 401 F.2d at p. 931, n.8.

interstate commerce, and established the Commission's regulatory power over public utilities engaging in either of these pursuits.[71]

However, quoting CL&P, the court further stated:

The expression "facilities used in local distribution" is one of relative generality. But as used in this Act it is not a meaningless generality in the light of our history and the structure of our government. We hold the phrase to be a limitation on jurisdiction and a legal standard that must be given effect in this case in addition to the technological transmission test.[72]

The court further rejected the Commission's concept that, in order to determine whether jurisdiction over any particular acquisition existed, the impact of local supervision be measured on a case-by-case basis. Quoting from Colton, the court stated:

[T]his "flexible approach"—involving as it does the consideration, inter alia, of "the effect of the regulation upon the national interest in the commerce"—has been flatly rejected as a technique for resolving jurisdictional conflicts between the Commission and state bodies. * * * We think that like the line "(i)t cut sharply and cleanly between sales for resale and direct sales for consumptive uses" to facilitate jurisdictional determinations in rate regulation, "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis," in distributing regulatory power over the acquisition of facilities.[73]

The court rejected the Commission's argument that jurisdiction over the merger or consolidation of jurisdictional

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71 401 F.2d at pp. 938-39 (emphasis added, footnotes omitted).

72 *Id.* (footnote omitted).

73 *Id.* at p. 949 (footnotes omitted).

facilities with those of any other "person" under section 203 gave the Commission jurisdiction over Duke's acquisition. The court stated that the FPA reflects a policy ` that matters largely of a local nature, even though interstate in character, should be handled locally and should receive the consideration of local [officials] familiar with the local conditions in the communities involved.'"[74]

Federal Power Commission v. Florida Power & Light Company[75] is the last major court case to address the Commission's transmission jurisdiction. In this case, the Commission sought to impose its accounting rules upon Florida Power & Light Company (Florida Power & Light). The company's system lay solely within the borders of Florida and did not directly connect with any out-of-state utility.[76] The Commission held that Florida Power & Light did own facilities that transmitted electric energy in interstate commerce, but the Court of Appeals for the Fifth Circuit ruled that the Commission did not have substantial evidence to support its finding.

The Supreme Court reversed. The Supreme Court noted that Florida Power & Light was a member of the Florida Power Pool along with Florida Power Corporation (Florida Power Corp.).[77] In turn, Florida Power Corp. connected with Georgia Power Company (Georgia Power) at a "bus"[78] south

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74 *Id.* at p. 936 (quoting from Hearings on H.R. 5423 before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 393 (1935) (testimony of then-FPC Commissioner Seavey)).

75 404 U.S. 453, *reh'g denied*, 405 U.S. 948 (1972) (*Florida Power & Light*).

76 404 U.S. at p. 456.

77 *Id.* at p. 456.

78 A "bus" is a connector or group of connectors that serves as a common connection for two or more circuits.

of the Georgia-Florida border.[79] Florida Power Corp. regularly exchanged power with Georgia Power.[80] In many instances, Florida Power Corp. transferred power to Florida Power & Light instantly after receiving power from Georgia Power, and transferred power to Georgia Power immediately after receiving power from Florida Power & Light.[81] The Supreme Court found that power commingled in the bus moved across state lines, and concluded that Florida Power & Light engaged in transmission in interstate commerce. The

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Court held that, to establish jurisdiction, the Commission need only show that "some (Florida Power & Light) power goes out of State."[82] The Court further explained that "(i)f any (Florida Power & Light) power has reached Georgia, or (if Florida Power & Light) makes use of any Georgia power * * * FPC jurisdiction will attach * * *."[83]

There is also a line of cases that address, among other things, what constitutes a Commission jurisdictional "sale of electric energy at wholesale"[84] under section 201 of the FPA.[85] These cases all concerned bundled sales. While the issues posed above involve unbundled wheeling, the "resale" cases are helpful to the extent they suggest that local distribution takes place only after power is subdivided. See,

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79 404 U.S. at p. 457.

80 *Id.*

81 *Id.* at p. 457 & n.8.

82 *Id.* at p. 461. (emphasis omitted).

83 *Id.* at p. 461 n.10. (emphasis added).

84 See Section 201(d), 16 U.S.C. §824(d) (1988).

85 *Public Utilities Commission*, supra note 345; *City of Oakland, California v. FERC*, 754 F.2d 1378 (9th Cir. 1985) (*Oakland*). *See also Alexander v. FERC*, 609 F.2d 543 (D.C. Cir. 1979) (*Alexander*).

e.g., 345 U.S. at 316 ("the facilities supplied 'local distribution' only after the current was subdivided for individual consumers.").

4. Natural Gas Act

The Natural Gas Act (NGA) was adopted in 1938. Like the FPA, the NGA contains language limiting the Commission's jurisdiction in situations involving local distribution.[86]

Section 1(b) of the NGA provides:

The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural.[87]

There is similarity in many respects between the House and Senate Reports on the FPA and the NGA with respect to the jurisdiction given the Commission. For example, all four reports mention Attleboro as placing interstate wholesale transactions beyond the reach of the States. As indicated in the House Report on the NGA, the States could "regulate sales to consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of congressional prohibition subject to State regulation." (See H.R. Rep. No. 709, 75th Cong., 1st Sess. 1). However, the House and Senate Reports on the NGA

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86 Courts often rely on cases construing the NGA when interpreting the FPA, and vice versa. *E.g., Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

87 15 U.S.C. §717(b) (emphasis added).

contain identical language not found in the reports on the FPA:

In view of the importance of section 1(b), which states the scope of the act, it seems advisable to comment on certain provisions appearing therein. It will be noted that this subsection of the bill, after affirmatively stating the matters to which the act is to apply, contains a provision specifying what the act is not to apply to, as follows:

But shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill. That part of the negative declaration stating that the act shall not apply to "the local distribution of natural gas" is surplusage by reason of the fact that distribution is made only to consumers in connection with sales, and since no jurisdiction is given to the Commission to regulate sales to consumers the Commission would have no authority over

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distribution, whether or not local in character. (Emphasis added).[88]

As a result of this language it can be argued that Congress considered distribution (and local distribution) only

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[88] H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 3 (1937).

in the context of bundled retail sales of natural gas. In fact, it appears that all of the court cases affirming the states' right to regulate local distribution of gas have involved bundled retail sales. See Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951) (Panhandle). There the Court, in affirming the State of Michigan's right to regulate an interstate pipeline's proposed bundled retail sales of gas to industrial consumers, noted that the pipeline company proposed to lay pipeline in "the streets and alleys of Detroit" and ignored the local distribution company's request for additional gas to meet the increased needs of the industrial consumers. Id. at 333. While the Court based its holding on a state's authority to regulate direct (retail) sales to an end-user, rather than on the basis of the section 1(b) local distribution provision, it also found that the proposed sales were "primarily of local interest" and "emphasized the need for local regulation." Id. Two years before Panhandle, the Supreme Court issued its decision in FPC v. East Ohio Gas Co., 338 U.S. 465 (1949) (East Ohio). East Ohio Gas Company owned and operated a natural gas business wholly within the State of Ohio. The company sold gas only to Ohio customers but most of the gas was transported to Ohio from other states by interstate pipelines. These interstate pipelines connected inside Ohio with East Ohio's large high pressure lines. The gas then was transported over 100 miles through East Ohio's system to its local distribution system. East Ohio argued that it was exempt from Commission jurisdiction because all of its facilities were local distribution.

The Court disagreed, finding the Commission's jurisdiction extends over the transportation of gas in interstate commerce through high-pressure transmission lines and that distribution did not begin until the point where pressure is reduced and gas enters local mains. The Court stated that: "[w]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among customers within a particular local community, not

the high-pressure pipelines transporting the gas to the local mains."[89]

The Commission relied in part on East Ohio's high pressure/low pressure distinction in a recent NGA section 7 certificate case which authorized construction of facilities to bypass the local distribution company.[90] On appeal, the California Commission argued that under section 1(b) it should at least have "jurisdiction over the 'taps, meters and other tie-in facilities' that link the pipeline to end users."[91] The court disagreed:

While as a matter of ordinary English 'local distribution' might be understood to encompass any delivery to an end user, that is hardly the only or even more plausible reading. Distribution conjures up receiving a large quantity of some good and parcelling it out among many takers.[92]

After reviewing the report language discussed above, the court also stated:

Insofar as congressional committees spoke to the matter * * * they appear to have viewed distribution as confined to its parcelling out function and (probably) even more narrowly, to parcelling out accompanied by retail sales.[93]

In Cascade Natural Gas Corporation v. FERC, et al. (Cascade), the court affirmed the Commission's authorizing

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89 338 U.S. at pp. 469-70.

90 *See Mojave Pipeline Company*, 35 FERC ¶61,199 (1986), *reh'g denied*, 41 FERC ¶61,040 (1987), *reh'g denied*, 42 FERC ¶61,351 (1988); *see also Mojave Pipeline Company*, 66 FERC ¶61,194 (1994), *reh'g pending*.

91 *See Public Utilities Commission of the State of California v. FERC, et al.*, 900 F.2d 269, 273 (D.C. Cir. 1990) (footnote omitted) (*WyCal*).

92 *Id.* at p. 276.

93 *Id.* (emphasis in original).

an interstate pipeline under section 7 of the NGA "to construct a tap and meter facility that would allow it to deliver natural gas directly to two industrial consumers

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* * *."[94] To reach the interstate pipeline, the industrials constructed a nine-mile pipeline. Together, the facilities bypassed the local distribution company.[95]

The court rejected arguments that section 1(b) deprived the Commission of jurisdiction holding that:

"Local distribution," as Congress viewed the term, involves two components: the retail sale of natural gas and its local delivery, normally through a network of branch lines designed to supply local consumers.[96]

5. Analysis

a. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier to a purchaser who will then re-sell the energy to an end user?

The case law supports the conclusion that any facilities of a public utility used to deliver electric energy in interstate commerce to a wholesale purchaser, whether such facilities are labeled "transmission," "distribution" or "local distribution," are subject to the Commission's jurisdiction under sections 205 and 206.

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94 955 F.2d 1412, 1414 (10th Cir. 1992).

95 Unlike the situation in WyCal where the pipeline made direct sales to end users, in *Cascade*, the pipeline transported gas purchased from third parties. *See Northwest Pipeline Corporation*, 51 FERC ¶61,289 at p. 61,909 (1990).

96 Cascade, 955 F.2d at p. 1421.

This conclusion is supported by Public Utilities Commission, supra, in which the Supreme Court, in the section of its opinion addressing the section 201(b) local distribution provision, held that local distribution facilities began "only after the current was subdivided for individual consumers."[97] Wisconsin-Michigan, supra, in which the Seventh Circuit held that there is no local distribution until the wholesaler who re-sells at retail is reached, is to like effect.

This conclusion, which results in a "functional" line being drawn to determine Commission jurisdiction, is not only consistent with the case law under section 201, but is also consistent with our interpretation of the line drawn under newly amended FPA sections 211 and 212. As long as electric energy is being sold to a legitimate wholesale purchaser, we believe the Commission has jurisdiction under sections 201, 205, and 206 of the FPA over the public utility's facilities used to deliver electric energy to that purchaser.

b. What facilities are jurisdictional to the Commission in a situation involving the unbundled delivery in interstate commerce by a public utility of electric energy from a third-party supplier directly to an end user?

In analyzing jurisdiction over unbundled retail wheeling, we believe it is important to distinguish between unbundled wheeling provided by the public utility who previously provided bundled retail service to the end user, and unbundled wheeling provided by other public utilities to the end user. For example, a former bundled retail customer may need unbundled wheeling services from its previous public utility generation supplier, as well as unbundled wheeling from one or more intervening public utilities, in order to reach a distant generation supplier. In this scenario, the

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[97] 345 U.S. at p. 316 (footnote omitted).

Commission believes it would have jurisdiction over all of the facilities used for the unbundled wheeling provided by the intervening public utilities.[98] The more difficult issue is whether some portion of the facilities used to transmit energy from the transmitting utility in closest proximity to the end user (the former supplier of the bundled product) is local distribution facilities. We believe that in most, if not all circumstances, some portion will be local distribution facilities.

The case law is replete with statements that the local distribution provision of section 201 must be given effect. However, the Supreme Court in both CL&P and Colton, supra, has stated that whether facilities are used in local distribution is a question of fact to be decided by the Commission as an original matter. Thus, there is no clear case law on a "bright line" between transmission and local distribution. In addition, regardless

[31,981]

of the details of the chain of delivery services necessary to move electric energy from the generator to the end user, in most cases the last public utility in the chain will use facilities that historically were considered local distribution facilities. Accordingly, unlike the situation involving unbundled wholesale wheeling, for which the case law clearly supports a "functional" test, the Commission believes the case law and practical realities of a changing industry support an analysis of local distribution facilities based on the facilities' functional as well as technical characteristics.

While it would be preferable to draw an absolutely "bright" line (e.g., based on technical characteristics such as voltage), the Commission does not believe this is required by

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[98] The Commission would not have jurisdiction over the rates for the sale of generation by the distant supplier because the transaction would be a retail sale of electric energy.

the case law and, importantly, would not be a workable approach in all cases because of the variety of circumstances that may arise and because utilities themselves classify facilities differently (e.g., one utility may classify a 69 kV facility as transmission; another may classify it as distribution).

Therefore, the Commission is adopting several indicators it will evaluate in determining whether particular facilities are transmission or local distribution in the case of vertically integrated transmission and distribution utilities:[99]

- Local distribution facilities are normally in close proximity to retail customers.
- Local distribution facilities are primarily radial in character.
- Power flows into local distribution systems, it rarely, if ever, flows out.
- When power enters a local distribution system, it is not reconsigned or transported on to some other market.
- Power entering a local distribution system is consumed in a comparatively restricted geographical area.
- Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
- Local distribution systems will be of reduced voltage.[100]

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[99] In the case of a distribution-only utility, which is franchised by a State or local government and sells only at retail, all of the circuits (and related wires, transformers, towers, and rights of way) which it owns or operates (regardless of voltage) would be local distribution facilities.

[100] The Commission has analyzed utilities' filings required by the Commission's regulations. These filings are made on FERC Form No. 1. While there is no uniform breakpoint between transmission and distribution, it appears that utilities account for facilities operated at

In summary, for unbundled wholesale wheeling the Commission will apply a functional test. The only definitive question will be whether the entity to whom the power is delivered is a lawful wholesaler. For unbundled retail wheeling the Commission will apply a combination functional-technical test that will take into account technical characteristics of the facilities used for the wheeling. The Commission concludes that these tests are consistent with the FPA, its legislative history and the case law discussed above.

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greater than 30 kV as transmission and that distribution facilities are usually less than 40 kV.